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The Entry Mode Choices of Multinational Corporations in Turbulent Markets: The Case of Ukraine

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Abstract

Entry strategies for the turbulent markets of Eastern and Central Europe are high on the strategic agenda of firms, who wish to capitalise upon the opportunities, which they represent, whilst minimising the risks. The rapidity and discontinuity of the change in these countries calls into question the validity of rational planning approaches to assessing market attractiveness. It also calls for re-examination of a number of the theories proposed for determining mode of entry. These are often predicated upon data gathered in stable market environments.

Literature relevant to the study of international entry strategies can be found in the fields of marketing, corporate strategy, international business, economics and organisational behaviour. This thesis takes the view that it is important not to prejudge which, if any, of the existing theories are relevant to study of entry into Eastern Europe.

Therefore, it takes an inductive, interdisciplinary approach to studying the entry decisions of fifteen multinational corporations in Ukraine. In-depth analysis of case studies in business-to-business service, mass-market and high-margin consumer goods and industrial product sectors is used to gain an understanding of these decisions. Data are explored within and between cases, to identify patterns of similarity and difference.

Firms are analysed according to demographic, location-specific and strategic variables derived from a review of literature. From this analysis, four groups of investment behaviour can be identified on the dimensions of criteria for entry, acceptance of risk and level of commitment to Ukraine. Both competitive and co-operative entry strategies are found. During the period of data collection, five additional decisions were made. Both positive decisions, to expand in Ukraine, and negative decisions not to expand or to withdraw were seen. Data were analysed to identify the explanatory variables for these differing fortunes. The findings are then set against their theoretical context to draw conclusions.

Chapter 1 - Introduction

> " 'If you could remove the uncertainty, there would be a major investment boom in 1995, leading to sustained and rapid growth to the end of the century.' If indeed: a condition of Himalayan proportions." The Economist, January 21st. 1995.

This assessment of the Russian economy, by Professor Richard Layard of the London School of Economics, points to the critical rôle of uncertainty in evaluating the attractiveness for foreign investors of markets in transition. The question of how to capitalise upon the potential of the emerging Eastern and Central European markets, whilst minimising the risks of operation in an uncertain environment, has risen to the top of the strategic agenda for many multinational corporations.

This thesis analyses the entry choices, which multinational corporations make in turbulent markets. The study is based on case analyses of fifteen entry decisions made with respect to the Ukrainian market. An interdisciplinary approach is adopted to allow for the inclusion of a broad range of variables, which might play a role in these decisions. An in-depth, theory-building methodology is preferred, as the process of transition to free market economy is one which calls into question the validity of existing theories, predicated upon empirical data collected in stable markets.

Success in international business may be attributed to a single phenomena, such as innovation in research and development or in marketing, but, more frequently, it is comprised of an amalgamation of factors:

> "the success of the modern international corporation is increasingly determined by the ability to organise natural resources, information, money and people

across national boundaries, both within and between organisations" (Dunning 1989)

Such conclusions have prompted calls, within the field of international business, for inter-disciplinary research approaches. Initially, international research tended to develop as an extension of existing disciplines, such as marketing or finance. A limitation of single disciplinary research might be the exclusion of important issues, which lie outside it's boundaries. Yet, researchers adopting an inter-disciplinary focus may face confront "warnings not to dabble in other experts' areas" (Buckley 1991b).

Within the field of marketing, the pre-eminence of quantitative, positivist studies has opened the discipline to the charge of "New Marketing Myopia" (Brownlie et al 1994). In the early 1980's, Day and Wensley (1983) suggested that the way ahead for marketing may be to adopt a more strategic focus. Hunt (1994) contends that, in the intervening decade, marketing "has made (...) few original contributions to the "strategy dialogue." He identifies over-emphasis upon quantitative studies as a contributory factor.

Easterby-Smith et al. (1991) suggest that the choice of methodology is influenced by the author's philosophical preferences and the nature of the research question. The literature relating to entry mode choice spans the disciplines of corporate strategy, marketing, organisational behaviour, international business and economics. The author's background is in the field of marketing. However, this does not imply agreement with the emphasis of a significant proportion of marketing literature upon theory-testing rather than theory building (Desphande 1983, Hirschman 1986, Hunt 1994).

Nowhere does a focus upon deductive methodologies present more of a problem than in researching Eastern Europe. Thomas (1993) says: "there is no precedent for a transition from planned to free market economy." Egan claims (1993):

> "In the market renaissance of Eastern Europe there is a cloudy past, an uncertain present and a speculative future (...) The research problem becomes acute, when the boundaries of knowledge are pushed beyond the environs of received wisdom."

Such is the situation in this research. Consequently, the chosen methodology must not prejudge which, if any, of the existing literature is relevant in answering the research question.

Moreover, against this turbulent backdrop, a number of areas of accepted wisdom must be subjected to further scrutiny. Many of the rational planning approaches to market selection were predicated upon the stable market environments of the 1960's and 1970's (Paul et al 1978, Kami 1976). However, their validity for the current period of discontinuous change has been challenged (Edwards and Harris 1977). Studies of internationalisation and entry mode choice propose models, whose empirical bases are in stable, advanced economies (Johanson and Vahlne 1977, Ansoff 1984). These may have limited explanatory power in uncertain market conditions.

Hunt (1994) also suggests that, despite the growing importance of "alliances, partnerships and relationships" in the field of marketing, research has paid little attention to the positive value of relationships. This claim overlooks the contributions to the marketing field, from the late 1970's onwards, of the interaction marketing and network literature (Håkansson 1982, Turnbull and Cunningham 1981, Easton and Axelsson 1991). Johanson and Mattsson (1994) sum up the difference between the marketing mix model and the markets as networks view as:

> "In the marketing mix model, studies of the role of exchange are basically limited to a comparative static perspective (...) In the network approach, the role of exchange is to co-ordinate the activities and resources controlled by one actor, with the activities and resources controlled by another actor (...) instead of focusing on the allocation of resources, the network approach is interested in the creation and co-ordination of resources through interaction in network relationships." pg. 323 - 324

Inter-organisational relationships, both within channel dyads and with a broader sphere of stakeholders, may be relevant to study of the entry choices of multinational corporations in Ukraine. Johanson and Mattsson (1988) contend that, for highly internationalised firms in highly international industries:

> "A further internationalisation of the firm only means marginal changes in extension and penetration, which on the whole do not imply any qualitative changes to the firm (...) Both with regard to extension and penetration the firm has possibilities to use positions in one net for bridging over to other nets." pg. 314

Thus, from a network perspective, investment decisions are not viewed as isolated incidents, but in relation to other stakeholders.

This thesis does not seek to prejudge the relevance of existing research. However, to ensure the internal validity of data, some structure had to be imputed. Propositions were gathered from a number of fields. Data were gathered using a semi-structured research instrument. Respondents placed their own emphasis on those issues, which they considered to have been the most important in their investment decisions. By a process of pattern-matching, data were explored to identify explanatory variables.

Harrigan (1983) suggests the use of fine-grained methodologies for in-depth or exploratory studies. Bonoma (1985) concludes that qualitative techniques, such as case studies, are best suited to theory building. Thus, the preferred methodology for this research is the use of case studies. Support for this choice comes from Yin (1983), who sees the case study as being appropriate to answer "how" or "why" questions about a contemporary event or events, over which the investigator has little or no control.

The empirical evidence, for this research, consists of twenty investment decisions. Data collection spanned the period from July 1993 to March 1994. From July to November 1993, data were collected for fifteen decisions to enter, or not to enter Ukraine. However, during the period of data collection, the market conditions in Ukraine worsened dramatically. By late 1993, five of the firms had made additional decisions, either to expand, or to exit from the Ukrainian market. Analysis of the additional decisions is also included in the thesis.

Following this introduction, chapter two reviews the literature, which is relevant to formulation of the research question and development of the research instrument. The scope of the relevant literature is broad. Accordingly the chapter synthesises the major contributions, rather than presenting an exhaustive review. From this synthesis, propositions are derived, which form the basis of the research instrument.

In chapter three, the choice of an in-depth, theory-building methodology is explained. Subsequently, the research process is described to show how it addresses the issues raised by carrying out rigorous academic research in a turbulent environment. The next two chapters provide the main presentation of the research data. Firstly, in chapter four, the composition of uncertainty in the Ukrainian environment is explored. Furthermore, the issue of how to analyse the environment is addressed. A contextual trend is derived, against which data can be analysed. Secondly, in chapter five, the data are presented by industry. The industry-level context is explored under the headings of business-to-business services, high-margin and mass-market consumer goods and industrial and high-technology products to identify the major influences upon the decisions studied. Case histories are presented for each of the fifteen firms. These are grouped under the relevant industry heading. Summary data are presented in tabular form.

Chapters six and seven cross-analyse the case data. In chapter six, the data on entry decisions are explored, across industry sector, to identify patterns of similarities and differences. Data are analysed by criteria for investment, attitude towards risk and level of commitment. From this analysis, typologies of market entry decision-making behaviour are presented. In chapter seven, data are studied for the expansion and exit decisions of five firms, which made additional decisions during the period of data collection. Data are analysed to identify explanatory variables for the differing experiences of multinational corporations in Ukraine.

Chapter eight sets the findings of the study in their theoretical context, in order to derive conclusions. Finally, chapter nine looks at limitations of the study and identifies areas for future research.

Chapter 2 - Literature Review

Within the field of management, research into international entry decisions exists within the areas of marketing, strategy, organisational behaviour and finance. It builds upon concepts drawn from both economics and sociology. Accordingly, synthesis of the literature is complicated both by the breadth of the field and by divergent methodological approaches. However, the greatest challenge in this chapter is that of identifying unifying themes to provide a framework for the literature review.

Firstly, definitions of uncertainty and risk are considered. Then, the consequences of uncertainty are explored under headings, which build on the framework of Forsgren (1989). Forsgren distinguishes between research, which adopts a rational-planning approach, and that which identifies patterns from streams of activities. Furthermore, he divides research into hierarchical studies, which assume firm-specific advantage and atomistic competition between firms (Buckley and Casson 1976, Porter 1985) and those which see the international firm as a "coalition of interests"(Cyert and March 1963), with a resource dependence upon other players in the environment (Pfeffer and Salancik 1978). Forsgren juxtaposes these two dimensions to form a matrix. For the purposes of this review, however, each of these categories is taken separately. Finally, the nature of the growing body of research into East and Central Europe is considered.

2.1 The Composition of Uncertainty

Analyses of risk and uncertainty in international investment decision-making vary both in terminology and taxonomy.

An important distinction between the two terms is that made by Knight (1921). Uncertainty is a composite of many hard and soft variables and, as such, is immeasurable. Risk, however, is the measurable impact of uncertainty upon the firm. The firm can quantify risk by some measure, usually financial:

> "Uncertainty must be taken in a sense radically distinct from the familiar notion of risk, from which it has never properly been separated. The term "risk", as loosely used in every day speech and in economic discussion really covers two things which, functionally at least, in their causal relations to the phenomena in question are categorically different (...) The essential fact is that "risk" means in some cases a quality susceptible of measurement, while at other times something distinctly not of this character (...) We shall restrict the term "uncertainty" to cases of the non-quantitative type".

Uncertainty is seen to stem from imperfection of knowledge:

> "We do not perceive the present as it is, and in its totality, nor do we infer the future from the present with any high degree of dependability, nor yet do we accurately know the consequences of our actions. In addition (...) we do not execute our actions in the precise form in which they are imagined and willed." (pg.203)

Miller (1992) builds on this distinction, defining uncertainty as the "unpredictability of environmental or organisational variables that impact corporate performance " and risk as "unpredictability in corporate outcome variables. "

In operating internationally, firms must overcome high levels of uncertainty. Mascarenhas (1982) indicates that there are higher levels of uncertainty in international business than in domestic operation:

> "If the domestic business environment can be labelled uncertain, the international business environment is doubly so. In going overseas, firms face, in addition to domestic sources of uncertainty, foreign exchange and political risk. Unfamiliarity with operating in a new environment, aggravated by

> labour restrictions, different cultures and infrastructural difficulties contributes to the uncertainty of the international environment."

Moreover, the period of discontinuous change, which has characterised the international environment since the mid 1970's, increases the levels of uncertainty faced by firms. This, in turn, compounds the risks which pertain to their decisions. The current situation in Eastern Europe is one, of which Thomas (1993) says: "there is no precedent for a transition from a planned to free market economy."

Egan (1993) claims:

> "In the market renaissance of Eastern Europe there is a cloudy past, an uncertain present and a speculative future (...) The research problem becomes acute, when the boundaries of knowledge are being pushed beyond the environs of received wisdom"

Within the literature, greater attention has been paid to the composition of macro-level environmental uncertainty, than to either industry- or firm-level analyses (Miller 1992). Research tends to focus on specific categories of uncertainty, such as political uncertainty (Rummel and Heenan 1978, Smith 1971) or psychic distance (Klein and Roth 1990). However, Miller (1992) sees limited value in research which stresses the impact on firms of one, or a limited subset, of the influences in the international environment. Such research, he feels, may overlook the impact of related variables:

> "A significant shortcoming in much of the existing risk and uncertainty literature is the emphasis on particular uncertainties rather than a multidimensional treatment of uncertainty."

A number of frameworks have been proposed in the literature for holistic consideration of uncertainty. These suggest the inclusion of a broad spectrum of variables. Buckley (1991) identifies a continuum of research foci from economic analyses, which tend to emphasis external market influences upon decisions, through to strategic considerations, which emphasise the role of managerial discretion. Pettigrew (1985a, 1985b) refers to the "outer" and "inner" context of the firm.

General Environmental Uncertainties	**Industry Uncertainties**	**Firm Uncertainties**
Political Uncertainties	**Input Market Uncertainties**	**Operating Uncertainties**
War	Quality Uncertainty	Labour Uncertainties
Revolution	Shifts in Market Supply	Labour Unrest
Coup d'état	Changes in quantity used	Employee Safety
Other political turmoil		Input Supply Uncertainties
		Raw Materials Shortages
Governmental Policy Uncertainties	**Product Market Uncertainties**	Quality Changes
Fiscal and Monetary controls	Changes in Consumer tastes	Spare Parts Restrictions
Price Controls	Availability of Substitutes	Production Uncertainties
Trade Restrictions	Scarcity of Complementary goods	Machine Failure
Nationalisation		Other random factors
Government Regulation		
Barriers to Earnings Repatriation		
Inadequate Provision of Public Services		
Macroeconomic Uncertainties	**Competitive Uncertainties**	**Liability Uncertainties**
Inflation	Rivalry among competition	Product Liability
Changes in relative price	New Entrants	Emission of pollutants
Foreign Exchange rates	Technological Uncertainty	
Interest rates	Product Innovations	**R&D Uncertainty**
Terms of trade		Uncertain results of R&D
Social Uncertainties		**Credit Uncertainty**
Changing Social Concerns		Problems with collectibles
Social Unrest		
Riots		**Behavioural Uncertainty**
Demonstrations		Managerial or employee
Small-scale terrorist movements		self-interest
Natural Uncertainties		
Variations in Rainfall		
Hurricanes		
Earthquakes		
Other natural disasters		

Figure 2.1

A number of frameworks split the variables into three groups. Dunning's eclectic paradigm (1982) highlights the influences of location-specific, ownership-specific and firm-specific factors. Kotler (1991) distinguishes between uncontrollable, macro-environmental factors, semi-controllable factors in the proximate environment and controllable factors at the channel level. Similarly, Miller (1992) categorises variables under the headings of General Environmental, Industry and Firm Uncertainties (See Figure 2.1). Whilst the framework of Reve and Stern (1980), built upon by Achrol, Reve and Stern (1983), divides variables into macro- and micro-level. The micro-environment of the firm is further split into the secondary-task or industry-level environment and the primary task, or firm-level, environment (See Figure 2.2).

A comprehensive review of the influences of variables, in each of these tiers, upon the investment decisions of multinational corporations is presented in the remainder of the literature review. The framework, used in this research for the purposes of analysis, is that of Achrol, Reve and Stern (1983). This is seen to provide the best visual representation, as it differentiates between the input and output sectors of the channel environment and between the regulatory and competitive sectors of the lateral environment.

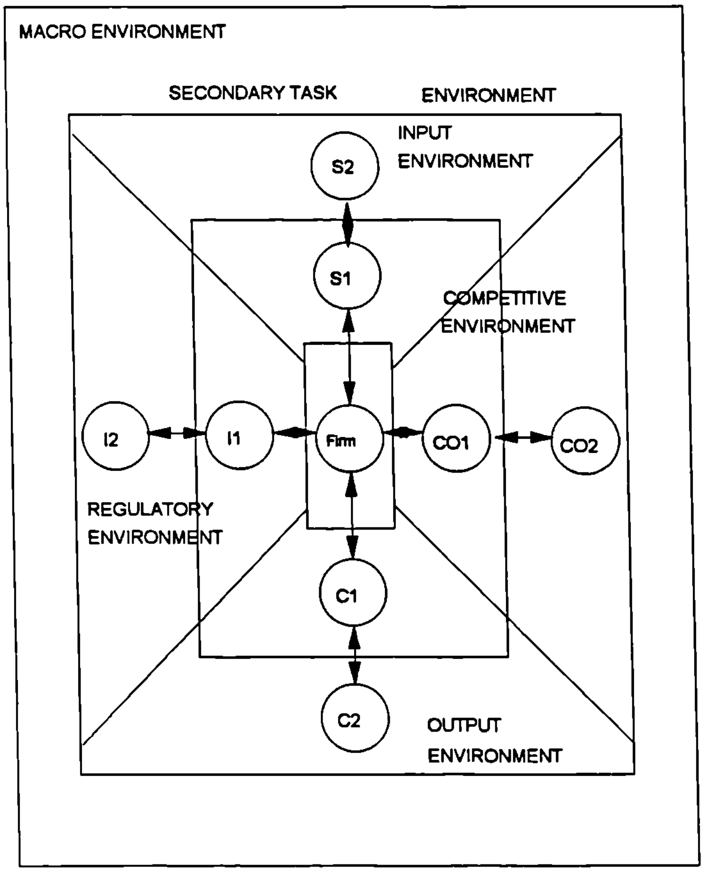
2.2 Rational Planning Approaches

Consideration has been given to methods of assessing of international risks and opportunities within the fields of corporate planning, finance and marketing.

Literature tends to use the terms uncertainty and risk interchangeably. However, the distinction, made in the previous section, will be used in this review. Studies of economic and political uncertainty predominate (Smith 1971, Kern 1985, Perlitz 1985, Rummel and Heenan 1978). Methods proposed for the assessment of the risks, which this uncertainty poses, range from observation to quantification, via Delphi techniques and multivariate analyses. There are a variety of aims, such as understanding the cyclicality of economic and political development (Smith 1971), the composition of political and economic uncertainty (Perlitz 1985, Rummel and Heenan 1978) and that of ranking countries by assigning scores. Such techniques are seen to help firms in the decision-making process.

> "At a practical level, the growing use of structured analyses for assessing country risks can be seen as a natural reaction to the increasingly difficult and complex problems facing those involved in international activities. Essentially,

this type of systematic approach attempts to identify explicitly and to quantify the international risks arising from business operations." (Kern 1985).



BASED ON FIG.1 "ENVIRONMENT OF MARKETING CHANNEL DYADS"

ACHROL, REVE AND STERN JOURNAL OF MARKETING 1983

I = INTEREST GROUP
C = CUSTOMER

CO = COMPETITOR
S = SUPPLIER

Figure 2.2

Risk assessment models allow for systematic appraisal of investment decisions and for comparison between investment opportunities. They build awareness, in decision-makers, of the factors, which may have an impact on the success or failure of investment decisions. Published risk indicators, such as those from Business Environment Risk Indicators or Economic Intelligence Unit, allow firms to use objective data, based on expert opinions.

However, risk analysis may not improve the decisions which firms make. There is a tendency to make normative assessments based on risk level. Both Goodnow and

Hansz (1972) and Litvak and Banting (1968) describe countries as hot or cold, dependent on their risk and opportunity scores. "Hot" countries are seen to be attractive and "cold countries less attractive. Yet, “hot” countries may not necessarily represent the best investment opportunities for a firm. There may be intense competition, from indigenous and other international firms.

A number of limitations of risk analysis relate to the dangers of "ad hoc" quantification (Rummel and Heenan 1978). Firstly, assigning scores may mask complex phenomena. It may lead to premature screening out of countries, in which profitable opportunities exist. Secondly, quantitative approaches have difficulty in incorporating "soft" factors, such as cultural and social differences, which may be critical to success of failure of market entry. Finally, such simplistic classification does not take into account the nature of the decision, nor else the characteristics of the firm, making the decision.

The second of these issues may be addressed by reference to the significant body of research, which focuses on ways of classifying cultural, or "psychic" uncertainty. Hofstede (1980) differentiates between the predominant culture of different national subsidiaries of IBM on the dimensions of masculinity/femininity, power distance, uncertainty avoidance and individuality/ collectivism. Hall (1960) distinguishes between high- and low-context cultures. High-context cultures give greater emphasis to the non-verbal context of business dealings, than do low-context cultures. Such considerations should be considered alongside quantitative risk assessment models.

Analysis of the cultural characteristics of a market, compared to the host country of the investing firm, might indicate the level of psychic distance. Psychic distance is defined as cultural dissimilarity, stemming from differences in language and customs. Forsgren (1990) defines it as: “all those factors which hinder information flows between two units.” The greater the psychic distance, the higher the level of risk in international transactions (Klein and Roth 1990).

Another limitation of risk indicators from secondary sources is that they do not take into account the decision, which is being taken. Kern (1985) stresses that the range of variables, which might play a role in international investment decisions, is broad. Most models can only focus on a limited subset of these variables. Consequently, he supports the use of Delphi techniques, as a means whereby firms can pick out the variables most relevant to a specific decision. Another technique, which can juxtapose macro- and micro-level consideration, is matrix-analysis (Hedley 1977, Cushman 1979, Wind and Mahajan 1981, Wind and Douglas 1981, Perlitz 1985).

Matrix analysis can capture a snapshot of the business portfolio of a firm. Well known matrix, or portfolio models, such as the Boston Consultancy Group (BCG) matrix, show the resource implications of strategic business units, which are at different stages of their lifecycle. A number of attempts have been made to extend existing models into the domain of international business (Cushman 1979. Perlitz 1985). These offer managers the ability to visualise the relative merits of a range of options. Matrices, such as the General Electric (GE)-Multifactor model allow firms to balance macro- and micro-level considerations.

However, the dangers of portfolio analysis are well-documented. Single variate analyses, such as the BCG matrix, are susceptible to criticism of the dimensions chosen (Day 1977, Wensley 1981). In the international realm, Perlitz (1985) extends the BCG matrix, to analyse the relative attractiveness of countries. He uses GDP growth and the country's share of world exports as the dimensions. However, assessing attractiveness on the basis of only two variables, even if their validity is acknowledged, may overlook important issues.

Nor are the problems of matrix analysis resolved by use of composite axes. Matrices may still be subject to bias from managers (Wind and Mahajan 1981). The weighting or scoring of variables might be biased to arrive at a preferred outcome. Ghemawat

(1991) suggests that such errors may be either "honest mistakes or deliberate distortions." Furthermore, matrix analysis may limit the creativity of managers by prescribing preferred strategies (Wind and Mahajan 1981, McKiernan 1992).

In marketing literature, Greenley and Bayus (1993) conclude that tools such as the PLC, portfolio analysis and perceptual mapping are perceived to be of little value in helping managers to make marketing decisions. A key reason for the inadequacy of such tools may be that the value of outputs is dependent upon the availability and reliability of data inputs.

McDonald and Leppard (1992) argue that the reduction of complex problems to two-dimensional matrices is an acceptable and pragmatic approach:

> "We accept that the purists among our readers might comment that the matrices we have included here are an oversimplification of complex problems. We would not argue with them on this issue, because intellectually, there is a lot of truth in what they say. Nevertheless, when practical decisions are required in a hard and competitive world, any "tools" which lead to higher quality outputs are not to be spurned lightly." pg. 3

Indeed, nor should they be! However, reducing the assessment of market attractiveness to two-dimensional models is at best difficult, at worst, dangerous.

A further challenge to the value of matrix-based approaches and to rational planning, as a whole, is posed by turbulent market conditions. Corporate planning gained credence in a period of relative stability. Paul et al (1978) contend:

> "With strategic planning's dependence on accurate forecasts, it probably was not accidental that such planning gained a wide acceptance during the 1960's, which were relatively stable and hence enabled forecasters to demonstrate sufficient accuracy.

Kami (1976) concurs:

> "Corporate planning during the 1960's was relatively easy. Businesses could concentrate on international operations, because external assumptions were

> "givens" with long-range predictability and few fluctuations (...) planning techniques of extrapolation and mathematical computation of future trends based on past history worked quite well."

He concludes that these techniques are not suited to the additional demands of discontinuity:

> "New conditions require new thinking, new techniques and new timing. It is time to proceed with a sweeping "self-renewal" to cope with the era of unpredictability."

The suggested new techniques may include tools such as scenario planning (Leemhuis 1985). Ghemawat (1991) suggests that scenario-building may be valuable in overcoming uncertainty. He contends that scenarios should be possible, but extreme. They must also be sufficiently different from each other that one option does not "outshine all the others across all scenarios." pg. 122.

New thinking might infer suggestions, such as that of Edwards and Harris (1977), that planning will cease to be a long-range process, but rather will be a "series of discrete and sometimes unrelated steps." Harrison (1976) suggests that long range plans will be hampered by uncertainty:

> "At present it is very difficult and probably impossible to make a reliable 5 year forecast. Any plan based on such a forecast is unlikely to come to fruition, as anticipated" pg. 91

As a result, plans are being seen as less of a "blueprint for the firm's future" and more as "a tentative aid to decision-making." Flexibility is of increasing importance. Firms do not wish to be "locked in" to a plan of action, which may be inappropriate before its implementation.

Investment decisions might no longer be decided, if ever they were, by a process of rational planning. Simple choices, such as risk versus reward decisions, might be involved (Leemhuis 1985). Cardozo (1989) argues that higher risks may be acceptable to firm, if there is an expectation of higher returns.

The question as to the value of rational planning in turbulent market conditions raises issues pertinent to this thesis. How do multinational corporations assess the attractiveness of the uncertain markets of Eastern Europe, subject, as they are, to discontinuous change? Are rational planning techniques, predicated upon data gathered in stable markets, applicable to such turbulent markets? What impact does the environmental uncertainty have upon the level of risk which they perceive to be acceptable in entering the market?

2.3 Identifying Patterns from a Stream of Activities

2.3.1 Behavioural Studies of Decision-making

Buckley (1989) refers to behavioural studies of foreign investment decisions as the "Corporate Decision-Making Approach". The work of Aharoni (1966) makes a valuable contribution to this field. In his study of foreign direct investment by US manufacturing firms in Israel, Aharoni focuses upon "the nature of the decision-making process in complex organisations". In doing so, he aims to identify:

> "elements in the baffling complexity of the organisational system which could explain the behaviour and make the variables inter-related and sensible." (pg. ix)

Aharoni rejects the notion of rational decision-making behaviour, which he associates with the economic perspective on decision-making, for it assumes:

> "a single decision-making unit with a single set of utility preferences, a knowledge of a reasonably full range of action alternatives and their consequences, and the capacity to make the appropriate calculations for selecting a course of action of maximum utility"

He contends, instead, that decision-making can only be understood as a process:

> "Decisions cannot be analysed in isolation from the system in which they take place. Small day-to-day choices and acts create unintended consequences and limit the decision-maker's freedom of choice in other, completely unrelated

> areas of endeavour. Any one decision is a part of a continuous stream of activities, and it is influenced by past decisions, interpersonal relations and other ongoing activities of the decision-maker." pg. 18

Aharoni's work makes three valuable contributions to understanding of foreign investment. Firstly, it identifies conditions, under which tolerance of uncertainty may vary. If individuals are held accountable for a decision, they may be less willing to tolerate high levels of uncertainty. Secondly, it raises the issue of the cost of gathering information. Perception of uncertainty decreases, as the amount of information one has increases:

> "organisations are continually gathering data and using them. However, partly because of the cost of information, partly because of the inability to get all of it, a formidable shroud of uncertainty remains." pg. 299

In consequence, organisations may need to include the cost of gathering information in any investment analysis. However, the cost of striving for perfect information may be so high that it exceeds the risks of the decision. In this situation, the economic argument might be to accept the uncertainty and invest in the market. Thirdly, gathering information plays an important role in building commitment to the decision:

> "In the process of gathering information, the investigator creates commitments through a perpetual sequence of encounters with other individuals" pg. 300

Such political considerations, within firms, have significant consequences for decision-making. Management may not use all of the available information. More importantly, the development of commitment to a project may lead to the screening of information: "so that only data conforming to previously held beliefs are gathered." (Aharoni 1966) The role of self-interested individuals within the organisation is reminiscent of the work of Cyert and March (1963), who highlight the role of "coalitions of interest" in firms. It is the central tenet of a significant body of research in the strategic decision-making area.

One such stream of research, leading from the Aston studies of decision-making, highlights the importance of political processes in strategic decision-making (Wilson et al 1986; Hickson et al 1986). Political activity may lead to "quasi-decisions" in which decision-making becomes a satisficing process, designed to reach a preferred outcome (Hickson et al 1986). Decisions can be classified as “bounded” or “unbounded”. Bounded decisions are constrained by pre-established organisational rules and procedures. However, unbounded decisions, which use new types of data or involve new areas of decision-making, are prone to conflict. Those with power are able to further their own interests (Wilson et al 1986). Higher risks can be seen to pertain if decisions are “precursive”: that is happening for the first time (Hickson et al 1986).

Like the rational planning literature, this research was carried out in stable market conditions. However, if the risks of making a precursive decision in stable market conditions are high, then an indication can be gained of the perceived risk involved in entering Ukraine. This is a precursive decision under conditions of uncertainty.

Forsgren (1989) stresses the political dimension of international investment decisions in multinational corporations. The organisational structure is no longer “mother-daughter” or “centre-periphery.” It is geocentric (Perlmutter 1966), in that it operates globally using a matrix organisational structure. Hedlund (1986) builds upon the concept of the geocentric organisation in describing the “hypermodern” multinational corporation as “heterarchic.” Heterarchy is an extension of geocentrism in the strategic sense. The heterarchic organisation seeks competitive advantages globally, rather than building on a firm-specific advantage in the domestic market. Furthermore, the heterarchic organisation is characterised structurally, in that it must address the conflicting demands of being both globally co-ordinated and responsive to the demands of local markets.

In the heterarchic multinational, subsidiaries may have sufficient power to instigate and implement investments. Forsgren sees three major implications of this. Firstly, strategic investments result from political processes in the group and involve actors from subsidiaries, as well as top managers. Secondly, heterarchic structures may move the locus of decision-making away from the home-market, thus enforcing the globalisation of the managers' mental-map. There may be psychic distance within the firm, as well as externally. Finally, their may a "struggle for legitimacy and symbolic action" between the Head Office and the subsidiary. Subsidiary managers may feel that they need to signal their importance by making large and visible decisions.

2.3.2 Studies of the Internationalisation Process

Within a number of fields, attempts have been made to look at the dynamics of the internationalisation process. Welch and Luostarinen (1988) suggest a gap between studies of the export decision and research into multinational enterprises. Recognition of this gap prompted the development of "process models" of internationalisation:

> "In essence, a more longitudinal view, a process perspective was called for."

A number of process models have been proposed. Aharoni (1966) builds a five stage model, which focuses upon the process of making the foreign investment decision. In the first stage, there must be a strong initiating force to propel the firm towards Foreign Direct Investment. In the second stage, investigation will be required. This may further the process or else lead to its abandonment. In the third stage, the decision is made to invest. In the fourth stage, the negotiation of the decision is carried out. Finally, the process will be subject to reviews and changes.

Other process models focus upon the stages of internationalisation from initial international operation to investment. However, their stages and the variables, upon which these are predicated, vary. Perlmutter (1966) bases the stages upon the firm's cultural orientation. Three distinct orientations are identified. In the ethnocentric orientation, the domestic culture dominates the firm. A polycentric orientation results, when the distinction between the domestic and "foreign" culture becomes blurred. Geocentric orientation refers to the stage, in which the firm operates as a multinational or global player. Ansoff (1984) proposes the stages of export, international and multinational firms. The distinction between the last two categories seems analogous to the move to from polycentrism to geocentrism.

Brooke (1986) sees the process of internationalisation as incremental. An initial distinction is made between selling knowledge and selling goods and services. Goods and services may be exported, distributed via sales and marketing subsidiaries or through a manufacturing subsidiary. Knowledge will remain as a contractual agreement, until the decision is eventually made to invest in a subsidiary. Progression to the next level of investment comes, when the previous mode is found to be "inadequate." The nature of this inadequacy is not explored. However, it is suggested that it may result either from unprofitability, or from too much success.

Probably the best known model of the internationalisation process is that of the Uppsala school (Johanson and Wiedersheim-Paul 1975; Johanson and Vahlne 1977). This stage model depicts a linear progression from exporting through knowledge agreements to foreign direct investment. The progression between these stages is based on the contention that firms' export and expansion decisions are inhibited by lack of knowledge of foreign markets. High levels of uncertainty, which must be overcome when entering new geographic markets, will result in the decision to use lower-commitment modes of operation. Firms will tend to enter those markets with lower psychic distance first. As the firm increases its knowledge of a market, it will increase its commitment to it.

The empirical evidence, upon which the incremental model is based, relates largely to Scandinavian firms (Johanson and Wiedersheim-Paul 1975; Wiedersheim-Paul et al

1978, Juul and Walters 1987). However, it has also been found to be a valid descriptor of firms in some industries in Japan (Yoshihara 1978), Germany (Dichtl et al 1984) and the USA (Davidson 1983). A number of studies suggest the relevance of this model of internationalisation for firms in the early stages of internationalisation (Cavusgil and Nevin 1982; Buckley, Newbould and Thurwell 1979).

Yet, the model has been found to be invalid in a number of other situations (Turnbull 1987; Sullivan and Bauerschmidt 1990, Erramilli and Rau 1990; Clark and Mallory 1992, Jatar 1992). Firstly, there is a debate as to what constitutes the discrete stages of the model and, indeed, as to the first or lowest stage of commitment (Turnbull 1987, Erramilli 1990). Secondly, empirical evidence exists to suggest that firms do not follow a uni-directional process (Jatar 1992, Terpstra and Yu 1990). Firms may follow different patterns of entry and expansion, depending upon their strategic intent in operating in the market. Jatar (1992) found that MNCs entering the Venezuelan brewing industry used high commitment modes of operation to open up end-user markets, but reverted to lower commitment modes once the distribution channels were established. Tersptra and Yu highlight "piggybacking," in which firms enter markets using experience gained from partner firms.

The validity of the model may be related to the type of product or service. Research into the internationalisation of service firms suggests that high commitment modes of operation may be necessary, because of the inseparability of the service from its provider (Zeithaml 1985, Berry 1980). However, Erramilli (1990) counters this view, proposing a distinction between "hard" services, where production and consumption can be de-coupled, and "soft" services, where they cannot. Whilst providers of soft services may need to enter international markets via knowledge agreements or FDI, hard services can be exported, especially given advances in technology (Dahringer 1991). Research also suggests that the entry choices of service firms may be restricted by high host-government tariff, and non-tariff, barriers (Nicolaud 1989). The incremental model is also found to be invalid for high technology industries (Sharma and Johanson 1987).

Length of international experience may influence entry mode. Significant international experience allows firms to generalise between similar markets and may result in firms skipping stages, or making larger steps (Forsgren 1989). Erramilli (1991) finds that service firms with greater international experience are more likely to enter markets, which are culturally dissimilar, than those with little experience.

Moreover, the empirical evidence for the model originates from stable, economically advanced nations. Accordingly, it is not clear whether it can be applied to turbulent market environments. Reid (1983) concludes that the Uppsala model is too deterministic and general. The firm's choice of entry and expansion modes is selective and context-specific. It can be explained by heterogeneous resource patterns and market opportunities. Indeed, in subsequent research, Johanson and Vahlne (1990) acknowledge that the explanatory power of the stage model is partial. Larger steps in the internationalisation process may be made if the firm has high levels of resources. Significant length of international experience allows the generalisation of experiences between similar markets. The model may not be applicable to decisions relating to turbulent markets.

More importantly, however, the basis of the model is open to criticism. Penrose (1959) identifies two types of knowledge: experiential, which cannot be transferred, and objective, which can be taught. Johanson and Vahlne (1977) contend that the knowledge required to overcome market uncertainty must be experiential and market specific. However, the growth of joint ventures and other modes of co-operation suggests that knowledge can be shared, to the mutual benefit of firms.

2.4 Atomistic Studies

Given the limitations of the stage model approach, Welch and Luostarinen (1988) suggest that the way ahead in studies of internationalisation may be to explore further the choices, which underpin the process. They identify these as risk, control and commitment. Miller (1992) stresses that firms must address the key issues of control and flexibility in order to "manage uncertainty."

Research into the degree of control, which the firm exercises over its operations, tend to be centred in economics literature. Key streams of literature are those of internalisation, the development of multinational firms and transaction cost analysis.

Internalisation of firm-specific assets, as a means of overcoming market imperfections, is a central tenet of theories as to the development of multinational corporations (Hymer 1960, Buckley and Casson 1976, Rugman 1980, Teece 1986). Buckley and Casson (1976) highlight a number of rival theories which contribute to this debate.

a) The Hymer-Kindelberger Theory
b) Aliber's Theory of Currency Area
c) Foreign Direct Investment (FDI) as a result of diversification
d) Vernon's Product Cycle Theories
e) Knickerbocker's Oligopolistic Reaction Theory
f) Aharoni's Behavioural Process (See Section *2.3.1*)
g) Spreading Risk through FDI

2.4.1 The Hymer-Kindelberger Theory

The seminal work of Hymer, in his PhD thesis (1960), gave rise to a school of literature often referred to as the "Hymer-Kindelberger" school. This body of literature addresses the question of why foreign-owned firms are able to compete with indigenous competition in an international market. Indigenous firms have the advantage of local knowledge, whilst foreign competitors must overcome the costs incurred by serving the market at a distance.

The explanations, which are put forward, rest upon the idea that the foreign firm has an exploitable firm-specific advantage (Buckley and Casson 1976, Hood and Young 1979). Kindelberger (1969) saw this advantage as resulting from marketing skills, superior management techniques, or possession of a patented technology. Caves (1971) focused upon the ability to differentiate products. Whilst Hirsch (1974) viewed firm-specific advantage as coming from continuous research and development activity.

However, Buckley and Casson (1976) highlight certain key limitations of these arguments. Firstly, it is assumed that firms will be able to exploit advantages, which they possess. Secondly, there is no explanation why firms invest in certain of their assets and not in others. Finally, theories tend to imply that firms make a single innovation. If this were the case, then licensing might, equally, be used to exploit the advantage.

2.4.2 Aliber's Theory of Currency Area

The work of Aliber (1970) is seen by Buckley and Casson (1976) to be in a similar vein to that of the Hymer school. It poses the same question of ability to compete in international markets. Aliber contends that currency variations play a role in foreign direct investment. The relative strength of the home currency of the multinational means that it can capitalise the same stream of expected earnings at a higher rate than host country firms (Hood and Young 1979). Buckley and Casson acknowledge the explanatory power of this theory in the case of the post-war expansion of US Multinational Corporations into Europe. This might be related to the relative strength of the dollar during this period. Similarly, Japanese firms' expansion into South-East Asia in the 1960's and 1970's might relate to the strength of the yen. However, in general the theory is questioned as it cannot explain:

> "the widespread cross-investment between Europe and the US. Nor could it account for either the investment of US firms within the dollar area, or multinational investment in LDCs where capital markets may be non-existent and foreign exchanges highly regulated." Hood and Young 1979, pg. 51

For the latter reason, Aliber's theory provides little insight into the entry by multinational corporations into Eastern Europe.

2.4.3 Foreign Direct Investment as a Result of Diversification

Research suggests that large firms tend to broaden their business both geographically, and in terms of product range (Caves 1971, Rumelt 1974, Grant et al. 1988). The tendency to diversify might be based on proactive criteria, such as exploitation of a firm-specific advantage, or reactive criteria, such as domestic saturation or excess managerial capacity (Olson and Wiedersheim-Paul 1978).

2.4.4 Vernon's Product Cycle Theory

The product cycle theory of Vernon (1966) identifies three phases in the life of a product, introduction, maturity and decline. These phases have related consequences for the production and marketing strategies of a firm. At the early stage of the product cycle, price elasticity is low, but products may need to be refined to meet customer needs and wants. At the second stage, there is less need for flexibility and greater need for cost efficiency. At the final stage, competition may be based entirely on price and the product may become a commodity.

These differing requirements have consequences for the international strategy of the firm. Buckley and Casson (1976) describe these as follows: the first phase looks at the determinants of the initial location of production, the second whether a market should be serviced by exports or by investment, and the final phase at how the firm can best compete against indigenous competition. Hood and Young (1979) suggest that the first stage requires only domestic production, the second exploiting international opportunities and the last relocating production facilities to areas with low labour costs. This might relate to the interest of some multinationals in locating production facilities in Eastern Europe.

However, the assumptions, upon which Vernon's model are based, relate to the stable market conditions of the 1960's. It may be applicable to the post-war expansion of US firms into Europe. However, the model's assumptions may no longer be valid. Labour costs in Europe have increased, therefore US firms are unlikely to enter the market in search of cheap production. It is not clear that the model is applicable in the current turbulent environment. Furthermore, Hood and Young (1979) suggest that, like Johanson and Vahlne's incremental model of internationalisation (1977) Vernon's theory may be more applicable to firms, which are making their first international investment, than to multinational corporations.

2.4.5 Oligopolistic Reaction Theory

Oligopolistic reaction theory was proposed as an explanation of the foreign direct investment behaviour of multinational corporations by Knickerbocker (1973). According to this theory, firms in the same industry sector tend to enter an international market at around the same time. Thus, once the market leader has entered, other firms in the sector follow. Buckley and Casson (1976) summarise this as follows:

> "the timing of foreign investment is determined largely by reaction to competitors' investments (...) Once one firm invests in a region, the optimal strategy for other firms is to 'follow the leader', even if this confers no immediate advantage on the follower, but simply spoils the market for the leader." Buckley and Casson 1976, pg. 78

However, they emphasise that Knickerbocker's work was inconclusive. Investment behaviour of a lead firm may prompt oligopolistic reactions. However, the timing of entry might, alternatively, be explained by possession of superior market information. Hence a firm, which has better market intelligence systems than rivals, may be able to assess the potential of a new market first. Accordingly, it would be the first to enter. Other firms within the sector might revise their opinions of the market's attractiveness, based on the knowledge that a competitor found it sufficiently interesting to enter. In this case, firms are indirectly influenced by each other, but are responding to the same set of market conditions.

Similarly, the time lag between the first and last entrants may depend upon the speed at which they assess market attractiveness. Hence Buckley and Casson stress:

> "if there is a high degree of uncertainty or the initiating firm does not appear to be doing very well, then firms may defer their investment, so that they can benefit from the experience of the initiator. On the other hand, if there is little uncertainty, or the initiating firm is earning high profits, firms will tend to respond very quickly (...) The theory, therefore, predicts that, across industries,

bunching of foreign investment will be positively associated with profitability and with the stability and cohesion of the market concerned." pg. 79

In Knickerbocker's view, the firms in this study should cluster together in their entry decisions. However, as the market conditions in Ukraine are very uncertain, Buckley and Casson's would expect the following firms to await the outcome of the leader's investment decision, before making a decision themselves.

2.4.6 Spreading Risk Through FDI

This extends the idea of an individual investor minimising risk by choosing a portfolio of investments in the international domain, rather than a single one. Thus, this view would contend that the multinational firm invests in a portfolio of countries to minimise the risk of economic downturn in any one market (Markowitz 1970). An efficient portfolio of investments would be one, in which "risk-aversion and expected value of returns are balanced" (Hood and Young 1979).

Both Buckley and Casson (1976) and Hood and Young (1979) point to the limited explanatory power of this theory. If multinational corporations followed a process similar to that of individual investors, one might expect them to take a large number of minority stakes. No insight is given into the decision to opt for a controlling interest in an operation:

> "There is (...) a *prima facie* case that a portfolio designed to reduce risk through diversification will not consist of direct investments, but of relatively small shareholdings in a large number of assets" (Buckley and Casson, pg. 82).

Furthermore, Buckley and Casson (1976) contend that multinational corporations do not need to diversify to reduce risk for their shareholders. Shareholders do this by investing in several ventures rather than one.

2.4.7 Buckley and Casson's Theory

As an alternative to these theories of multinational development, Buckley and Casson propose a comprehensive model, comprised of four sets of factors which influence the long-term development of a multinational corporation. These are:

(i) Industry-specific factors
(ii) Region-specific factors
(iii) Nation-specific factors and
(iv) Firm-specific factors

The main emphasis is placed on the first of these sets of factors. The location strategy of a vertically-integrated firm is seen to be determined by a combination of comparative advantage, barriers to trade and regional incentives to internationalise. Buckley and Casson propose that firms:

> "will be multinational whenever these factors make it optimal to locate different stages of production in different nations" pg. 35

Attention is paid to the role of knowledge, which may be internalised because of the problems arising from pricing and protecting it in the external market.

This view is supported by the findings of Rugman (1980), who suggests that the multinational enterprise exists as a response to government-induced failure, such as tariffs and controls. Internalisation, he contends, may overcome market imperfections in the pricing of knowledge and information. Hood and Young (1979)suggest that a difficulty may arise when validating the internalisation hypothesis empirically. A key contribution, in attempts to understand the decision to internalise or to access resources externally, may be offered by transaction costs analysis.

2.4.8 Transaction Cost Analysis

Williamson (1975, 1981) uses transaction costs as a means of explaining the choice between internalising a capability and accessing it externally. In his view, governance structure is determined by the costs of transacting outside the organisation. Behavioural factors, such as the bounded rationality of managers and opportunistic behaviour, increase transaction costs. In situations of small numbers bargaining, when there are few alternative suppliers or buyers, and in cases of high asset specificity, hierarchical control is seen to reduce uncertainty.

Transaction costs need not be a rival to internalisation theory. Teece (1986) contends that theories of internalisation can be complemented by transaction cost analysis. The transaction is seen as a means of comparing the interaction between buyers and sellers in free markets and in hierarchies. Buyers and sellers become locked into relationships by the creation of transaction-specific assets. However, self-interest will result in opportunistic behaviour, as both parties seek to gain as much of the advantages of the transaction, as possible. Internalisation is seen as a governance structure which reduces opportunism. Teece (1986) concludes:

> "Developing the rent stream associated with [certain unique] assets often requires the extension of some kind of hierarchical control structure over productive assets, which are distributed internationally. Within this hierarchical control structure, technology and other intangible, difficult-to-protect- and-transfer assets can often be deployed more economically and securely."

There are many criticisms of the transaction cost approach. Firstly, it assumes that opportunistic behaviour exists only in transactions outside of the firm, a view challenged by the evidence of behavioural studies (Cyert and March 1963, Aharoni 1966; Hickson et al 1986). Secondly, transaction cost analysis focuses upon dyadic relationships. Yet, the dyad may be affected by the actions of other firms, or indeed the network of firms with which it is interconnected (Johanson and Mattsson 1987). Finally, Teece (1986) suggests that transaction costs can be used to gain a fuller understanding of internalisation. However Buckley (1988) points to the difficulty of operationalising transaction cost analysis. Transaction costs can be classified into information costs, bargaining costs, enforcement costs and governance costs, but there are no estimates of how significant these are, in comparison to transport or marketing costs.

2.4.9 Control versus Risk

Despite their limitations, transaction costs have formed the basis of a number of studies (Anderson and Gatignon 1986, Klein and Roth 1989, Jarillo 1988). Anderson and Gatignon (1986) use transaction costs to explore the relationship between control and risk. Control implies commitment of resources, which in turn, creates risks for the firm. The optimal entry mode is seen to be a trade-off between the level of control, which the firm chooses and the risk which this poses in terms of resource commitment.

Incremental models suggest that greater control is taken, in an international market as uncertainty is overcome. However, Erramilli (1991) suggests that product or service firms may have different criteria for the level of control, which they choose. He depicts a "U-shaped" relationship between experience and desired level of control. Firms with little international experience and those with significant levels both require a high level of control. Desire for high levels of control, in firms with little international experience, may be based on the concern with psychic distance and uncertainty suggested by Johanson and Vahlne (1977).

Those firms with high levels of experience were often concerned about guaranteeing consistent service quality across markets. Erramilli suggests that perceived need for control may be higher for service industries than manufacturing firms and that, in consequence, international operation for service firms may involve higher levels of risk. Shared control is more likely when asset-specificity is high, when services are inseparable and as country-risk increases (Erramilli 1991). Thus, the service firms in this research might be expected to make different entry choices to the product firms.

2.4.10 Commitment

Throughout the literature, the concept of "commitment" recurs. However, different, and sometimes contradictory, definitions are proposed. To Aharoni (1966) commitment is built during the process of foreign investment decision-making. As the decision nears implementation, previous actions have built "commitment" to its taking place. Essentially, therefore, commitment is an organisational phenomenon.

To Johanson and Vahlne (1977), commitment seems to equate most readily to "total investment," all that the firm puts at stake in making an investment. This may include financial resources and company reputation. This must be surmised, as they do not clearly define the composition of commitment. By this view, commitment is predominantly a financial concept.

Ghemawat (1991) sees commitment as "the tendency of a strategy to persist over time." He proposes the concept of "cumulative constraints," which may incline the firm to remain with a course of action, once it is initiated. This view of commitment offers a significant contribution to understanding the investment decisions of multinational corporations. Ghemawat contends that commitment should be considered in conjunction with competitive intensity. For example, if a firm commits to the development of a new technology, which provides an advantage over competitors, it calculates the likely return based on the potential benefits it will accrue. If competitors develop the same, or a substitute technology, during the period of development, the return may be significantly reduced. The firm:

> "tends to assume away any differences in the reactions of competitors and other interested parties to the organisation's choice of one strategic option (intended long-term positions) as opposed to another. Ghemawat pg. 80

Furthermore, commitment to a strategy may be altered by subsequent events:

> "the receipt of new information may induce the organisation to revise its course of action (...) [However, calculation of return on investment] assumes that the organisation will persist, without further recourse, with the course of action favoured by the option it initially elects to pursue." pg. 80

Ghemawat stresses the need for organisations to be flexible and to adapt, in the light of competitive reactions. Firstly, Ghemawat highlights the number of revisions which firms make even to commitment-intensive decisions. Secondly, he challenges the assumption that "investment always reduces flexibility, while not investing always preserves it" pg. 124

Building upon Ghemawat's view of commitment, a distinction can be drawn between the concepts of control and commitment, where the latter implies being locked into a course of action. A firm can opt for a high level of control, without necessarily having a high level of commitment. For this research, the distinction could be important. Choosing a high level of control, such as direct investment, may not commit a firm to the Ukrainian market.

Whilst Ghemawat still implies an atomistic view of competition, his recognition of the need for flexibility and his consideration of inter-relationships between the decisions, which a firm makes, and those of other firms, is nearer to the view of network theory.

2.5 The Inter-relationship of Firms

The question of co-operation, rather than competition, between firms raises another possible source of influence upon international investment decisions. The firm may be affected by its relationships with customers, suppliers, competitors and other stakeholders in its environment.

In 1965, Alderson identified a relative dearth of literature in the marketing field which looked at co-operative rather than competitive behaviour:

> "Co-operation is as prevalent in economic activity as competition... Economists speak of competitive theory, of pure and perfect competition. There is no corresponding development of co-operative theory, no concepts of pure and perfect co-operation"

The last three decades have witnessed a significant growth in research focusing upon the benefits of co-operation as well as competition.

The traditional view of marketing is that it is an exchange process between buyers and sellers (Bagozzi 1975). Basic assumptions of the "Marketing Mix" approach are of atomistic competitors serving buyers, who must decide between the relative merits of their product or service offering (Johanson and Mattsson 1994). However, a growing body of literature, within the marketing, field focuses on the benefits of co-operation, rather than competition.

Research into marketing channels, into the interaction between industrial buyers and sellers and into networks, centres upon consideration of the nature of exchange relationships. Johanson and Mattsson (1994) see the temporal focus as a key distinction between this research and the marketing mix approach. They contend that the marketing mix approach implies static comparison. The firm is concerned with the attractiveness of their product or service, compared to competitors. This is essentially static, although there may be development of products over time. The network perspective is considered to be more dynamic. The focus is upon the development of the relationship between a buyer and seller over a period of time. Channel literature, interaction models and network research differ essentially in the type and number of relationships which they study.

Channel literature focuses upon the nature of the relationship between sellers and the channel intermediaries, which they use to reach the end consumer. Literature in the channel strategy area has emphasised the roles of power and trust. Two main perspectives have been adopted. Firstly, that which focuses upon power imbalances, which may result in conflict (Lusch 1976, Etgar 1978, Hardy and Magrath 1989). Conflict in the relationship is often seen to preclude co-operation (Lusch 1978, Etgar 1978). However, power imbalance need not lead to conflict, if both channel members attain mutually beneficial goals. Indeed Boulding (1965) contends that conflict can even stimulate performance, provided it does not exceed certain levels. The second approach contends that co-operation, based on trust and goal congruence, may offer significant benefits to both partners (Young and Wilkinson 1989, Narus and Anderson 1986, Jackson 1985).

Originally based on research carried out in Sweden, at Uppsala University and Stockholm School of Economics, the work of IMP, the Industrial or International Marketing and Purchasing Group, across Europe has given rise to a valuable body of research. This centres around the interaction between industrial buyers and sellers (Turnbull and Cunningham 1981, Håkansson 1982, Turnbull and Valla 1986). The buyer need not be a channel intermediary.

The interaction model (Håkansson and Östberg 1975, Håkansson and Wootz 1975a, 1975b) marks a decisive watershed in marketing literature. Previous research differentiated little between industrial and consumer marketing. However Håkansson and Östberg view industrial buyers as characterised by their concentration and relative power. This makes them active participants in the exchange process.

In the interaction model (Figure 2.3) the degree of social exchange and mutual adaptation are seen as key determinants of power dependence and, hence, relationship stability. Successful relationships are seen to be built upon trust, rather than formal commitment (Håkansson 1982). Strong inter-firm relationships favour information exchange, which is a key stimulus of innovative product development.

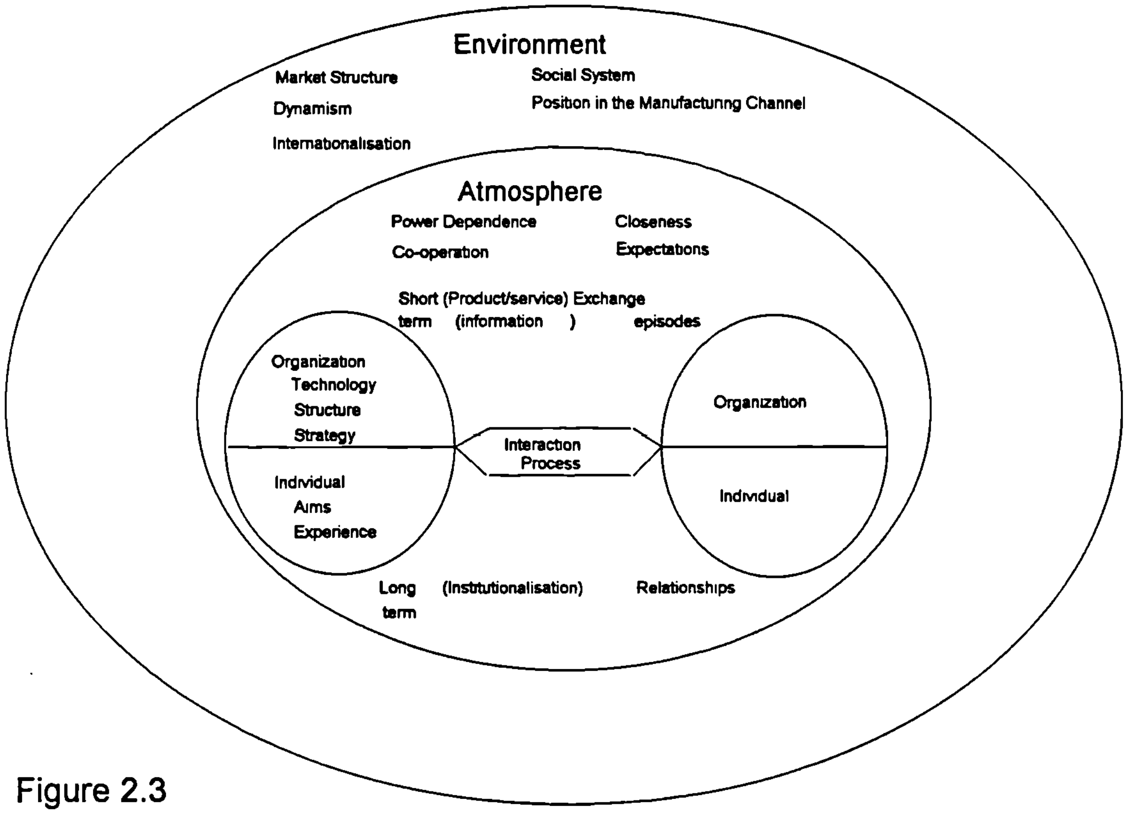


Figure 2.3

The network paradigm builds upon the work of the interaction model. It differs in its focus. In its simplest form, the network may simply be seen as aggregation of the interaction model. However, a key distinction is that each relationship may be influenced by other direct and indirect relationships, which the actor has. Hence, the network approach assumes strategic interdependence of the firm with other firms in the environment (Johanson and Mattsson 1985). Seyed-Mohamed and Bolte (1992) express this as follows:

> "The position of a firm, in a network, is directly dependent upon its relationship with counterparts, but indirectly dependent upon the counterpart's relationships with others" pg. 215

A key issue in network research is the complexity of the field of relevant literature. A range of complementary, and often overlapping, bodies of literature contributes its development. However, these are not similar in all respects. Views do not always remain constant. Authors have developed their research over time, often arriving at different conclusions. Moreover the terminology can be confusing:

> "The same terms may be used but they are often built up from different assumptions and have different meanings" Axelsson 1992)

The network has variously been defined as:

> "A set of relationships, whereby actors gain access to scarce resources" (Håkansson and Johanson 1992)
>
> "the totality of all units connected by a certain type of relationship" (Aldrich and Whetton 1981)
>
> "the totality of relationships among firms engaged in production, distribution and the use of goods and services in what might best be described as an industrial system" (Easton 1992)
>
> "consisting of 'nodes' or positions (...) and links manifested by interactions between the positions" (Thorelli 1986)

Whilst Thorelli (1986) saw the network as intermediate organisational type, between markets and hierarchies, the other definitions focus upon the fact that the firm is embedded in its environment. Identification of the key features of the network is often influenced by the focus of the research. Hence, Håkansson and Johanson (1992) stress the key role of "actors" who perform and control "activities" in order to access "resources." By this definition, relationships between actors are a means of gaining access to scarce resources, in a way reminiscent of Pfeffer and Salancik's resource dependence model (1978).

Johanson and Mattsson (1987) focus upon the relationships within networks. Whilst Easton (1992) offers a comprehensive review of the provenance and composition of the network under the headings of "networks as relationships", "networks as structures", "networks as positions" and "networks as process." Adopting these headings the following key features of networks can be identified:

2.5.1 Networks as Relationships

In his seminal article, Thorelli (1986) highlights the flow of power, information, money and utilities within the network. He stresses that flows of goods and money may be less important than those of information and power. Mattsson (1984) also distinguishes between technical, knowledge, economic or social exchanges. At different times a relationship may involves some, or all, of these types of exchange. In industrial networks economic exchange is a given. However, non-economic exchange:

> "may moderate the importance of purely economic considerations such as price in deciding the continuity of the relationship (Easton 1992).

It is recognised that, in other types of networks, economic exchange may be absent. Indeed, there may be relationships of other types within industrial networks, such as informational or social links between competitor firms.

Relationships may be direct or indirect. Indirect relationships can be seen as providing the linkages, which distinguish between interaction studies of dyadic exchange and network approaches (Easton 1992). Firms may act as flow through nodes for exchanges between two other firms (Easton and Lundgren 1992, Smith and Laage-Hellman 1992).

Moreover, relationships may be of different strength. Strong, stable relationships are seen as a valuable means of overcoming uncertainty. Firms may gain information through their relationships (Jarillo 1988). They can gain significant benefits from building ongoing relationships, in which partners may increasingly tailor their mode of operation to foster the co-operation (Turnbull and Cunningham 1981, Cunningham and Culligan 1991). The development of stable relationships, within networks, has been described as "co-ordination" (Hertz 1992) or "structuring" (Håkansson 1992).

2.5.2 Networks as Structures

The number of relationships, their "quality," or intensity, and their "type," or closeness to the core activities of the firm, are defined by Thorelli (1986) as determining whether a network is tight or loose in its structure. Thorelli recognises the co-existence of conflict and co-operation within the network:

> "We should expect the struggle for resources requisite for survival and growth to be reflected in intra-network friction and conflict as well as co-operation. Clearly the network is a polity, a 'political organism.' "pg. 40

The firm must not view itself as isolated, but in relation to other firms, with which it is connected. The current structure of the network, and the investment in relationships to date, will have an impact upon the opportunities which the firm has in the future (Mattsson 1989). This is because the position, which the firm holds in the network, is defined by its relationships with other firms. In "tightly-structured" networks (Johanson and Mattsson 1988), there is high inter-dependence between actors, bonds are strong and the position of firms vis à vis each other is well-defined. In "loosely-structured networks" the bonds between actors are weak, and the positions which they hold are less well-defined.

2.5.3 Networks as Positions

Thorelli (1986) defines position as a "location of power to create and/or influence networks." Positions are seen to be important for the development of the firm. A key implication of the network perspective is that the firm must invest in developing its position in the network:

> "On entering a network the new member faces the strategic challenge of positioning himself among the pre-existing members of the network (...) The established members may have to do some repositioning to accommodate the new member (...)."positioning of the firm in the network becomes a matter of as great strategic significance as positioning its product in the marketplace." Thorelli 1986, pg. 42

The investments which the firm makes, both in its internal development and within the external market, are seen to be influenced by its network relationships:

> "Positions take time and resources to develop. The firm's access to other firms' assets is mediated by its positions and those positions are in themselves a result of investment processes.(...) Present positions define restrictions and opportunities for the future use of (...) assets and development of the positions" Johanson and Mattsson 1985 pg. 188

This interdependency between firms is supported in later research (Johanson and Vahlne 1990) (See Figure 2.4)

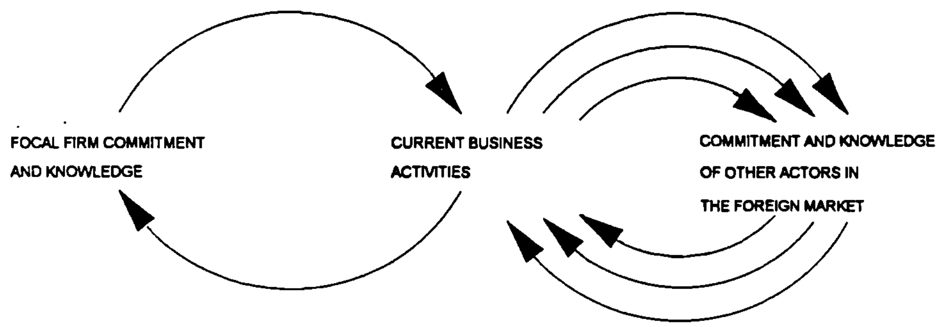


Figure 2.4

Håkansson and Snehota (1989) also recognise the imperative of studying the firm in relation to other firms:

> "Reciprocal knowledge and capabilities are revealed and developed jointly and in mutual dependence by the two parties. Distinct capabilities are thus generated and have meaning in an organisation only through the medium of other parties. They are unique to each party, since no two sets of related organisations are alike. In this sense, the identity of an organisation is created in interaction with its major counterparts." pg. 191

Johanson and Mattsson (1985) distinguish between micro-positions and macro-positions. Micro-positions are characterised by:

"a) the role of the firm in relation to the [other] firm
b) its importance to the other firm
c) the strength of the relationship with the other firm"

whilst macro positions are characterised by:

"a) the identity of the other firms with which the firm has direct relationships and indirect relationships in the network
b) the role of the firm in the network
c) the strength of the relationships with other firms
d) the importance of the firm in the network"

This distinction allows for further consideration of the development of firms in networks. Originally, macro-positions were seen to be aggregations of micro-positions (Johanson and Mattsson 1987), but subsequent research amends this view (Johanson and Mattsson 1988). Macro positions are affected by interdependencies in the whole network, as well as by the direct relationships, which determine micro-position. Aggregation of micro-positions cannot reflect the complexity of the interactions, which define the macro-position. A key consequence of this distinction is the view that networks should be studied holistically and cannot meaningfully be disaggregated. However, a disparity of views can be seen within the network literature.

In studies of the relationship, the network is often simplified to its most basic level, that of the single relationship. Thus, the dyad has been used by Easton and Araujo (1992) in their analysis of economic and non-economic exchange types. Similarly, Ford, Håkansson and Johanson (1986) consider the co-existence of co-operation and conflict within the single relationship. Whilst Smith and Laage-Hellman (1992) use the triad as a vehicle to demonstrate more complex resource transformation patterns in relationships.

However, this atomistic approach has key limitations. It oversimplifies the nature of the relationship. If micro-positions cannot be aggregated to form macro-positions, then extrapolation of a single relationship can never fully express the network. Nor can atomistic studies reflect the richness of complex interchanges between firms.

Yet, the alternative holistic approach to the study of networks is also fraught with problems. Sharma (1989) takes a macro-level approach, in his study of network operation in the technical consultancy market. Similarly, Lorenzoni and Ornati (1988) consider constellations of firms within the Italian textile industry. A major difficulty in holistic consideration of the network is that of deciding the boundaries of the network. Moreover, the complexity, which results from the holistic approach, makes it difficult to see how it could be developed beyond case analyses of specific industries, without becoming unwieldy.

A compromise is proposed by Cunningham and Culligan (1991), who recognise the existence of "focal nets". A focal net is seen to consist of:

> "relations above a certain minimum degree of closeness to a focal or "hub" firm. The focal net defines the set of the most important relationships for that focal firm at any one point of time."

Andersson et al (1990) take a similar view, claiming:

> "Industrial networks are unbounded and can extend without limits. Boundaries suitable for analytical purposes can be drawn, as a result of perspectives, intentions and interpretations"

Whilst it is recognised that it may exclude some relationships, this pragmatic approach is favoured for this research, as a way of taking into account the impact of the most important of the focal firm's relationships.

2.5.4 Networks as a Process

The flexibility of the network is an important facet of its value as an organisation form (Miles and Snow 1986). Hence, whilst both IMP studies and network literature stress the value of long-term stable relationships, both recognise the dangers of stagnation.

Consequently, Håkansson (1992) recognises the role of both "structuring" and "heterogeneity" within networks. Lundgren (1992) focuses upon continuous and discontinuous change within networks. Young and Wilkinson (1994) recognise that

different duration and types of relationships may be best suited to different purposes. Whilst Young and Denize (1994) find that some buyers stay with existing suppliers, even when they are no longer gaining good service, because they are "stuck" in the existing relationship. There is a recognition in the literature that loosely-*structured* networks are subject to greater change than those which are tightly structured. This may relate to the strength of the positions, which the actors have developed.
Another key dimension of the network as a process is the co-existence of conflict and co-operation. The firm may have information links with its competitors. However, it will not co-operate with it in ways which jeopardise its own welfare. The balance between these apparently contradictory forces is explored by Cunningham and Culligan (1991), who consider the ways in which co-operative relationships can contribute towards the creation and continuation of competitive advantage.

2.6.1 Networks and Internationalisation

The network view of the firm has particular implications for research into internationalisation. A number of variables have been proposed by extant literature as potential influences upon the decision to enter new international markets and upon entry mode. The network view opens up the possibility that the most appropriate organisational mode is co-operation, either formally or informally. Robinson (1986) concludes:

> "It boils down to which value-added links are most likely to enjoy international economies of scale (...) if performed by external specialist firms, economies which may swamp any benefits derived from the internalisation of the transaction"

Jarillo (1988) suggests that firms should access resources externally, if the cost of doing so is less than internalising the transaction.

A stronger contention of the network paradigm is that the actions of firms cannot be viewed atomistically, but must be understood in the context of the relationships, which they have with other stakeholders in the market. Research shows that the market entry of firms is influenced by relationships which they have in home and host market networks:

> "According to the network model, the internationalisation of the firm means that the firm establishes and develops positions in relation to counterparts in foreign networks." (Johanson and Mattsson 1988).
>
> "A corner stone in the network view is that it regards firms as engaged in more or less lasting relationships with other actors in the business arena, the main managerial task being to handle their interaction." (Forsgren and Johanson 1992, pg. 2)

Thus, from a network perspective, internationalisation is the process whereby the number and strength of the relationships between the different parts of the global network increases. The position, which an individual actor holds in a network, may differ between markets. Forsgren and Johanson (1992) contend:

> "Sometimes the firms compete on their own, sometimes they co-operate with other actors in ever changing patterns. The traditional distinct roles in the market place as suppliers, customers and competitors are becoming mixed. Competitors in one market co-operate in another and are suppliers and customers to each other in a third." pg. 1

As, in the strictest sense, network theorists would contend that the world market is part of the same network, Johanson and Mattsson (1988) adopt the convention of referring to subsets of the overall network as "nets." They identify the existence of national "nets" and of production "nets," for firms producing the same product. This latter seems to equate to industries. Based upon degree of internationalisation of the firm, and of the industry sector, in which it operates, Johanson and Mattsson identify four types of firms. They see each of these as facing different imperatives in international development (See Figure 2.5):

		Degree of Internationalisation of the market: Low	Degree of Internationalisation of the market: High
Degree of Internationalisation of the firm	Low	The Early Starter	The Late Starter
	High	The Lonely International	The International Among Others

Figure 2.5 Source: Johanson and Mattsson 1988

Whilst the Early Starter cannot count on using existing relationships to internationalise, the other three types can use existing domestic, or international, links. The Lonely International must compensate for its isolation in the foreign market by close integration of activities within its own multinational organisation. The Late Starter can be "pulled out" by customers or suppliers:

> "Thus market investments in the domestic market are assets which can be utilised when going abroad. In that case it is not necessary to go from the nearby market to more distant markets and the step abroad may be rather large in the beginning."

The International Among Others operates in global markets against global competition. Its activities are closely related to other firms in the same national or production nets. This type of firm is seen as having greater ability to externalise activities. Therefore, Johanson and Mattsson contend that the theory of internalisation is less relevant:

> "If both the firm and its environment are highly internationalised, it seems that a model which aims to explore Multinational Enterprise loses some of its relevance for analysis of further internationalisation."

Similarly, the stages model is seen to be less applicable to highly internationalised firms in highly internationalised industries. Forström (1991) concurs with the view that the further internationalisation of multinational firms may raise a different set of issues.

2.6.2 The Transition from Hierarchies to Markets: the Role of Networks

Whilst it would be untrue to suggest that management research was not previously interested in Eastern and Central Europe (Cieślik 1989, Nigh et al 1990), liberalisation has brought an exponential growth in the body of literature addressing the issues of operation in the region (Kraljic 1990, Czinkota 1991, Hooley et al 1992, Cox and Hooley 1993, Pitt-Watson 1993, Lawrence and Vlatchoukis 1993, Yamin 1994, Paliwoda 1995).

Much of this literature focuses upon the opportunities and obstacles in the process of transition to free market economy. This may take the form of analysis of a particular aspect of the environment (Kraljik 1990, Czinkota 1991). It may offer practical insights into the nature of doing business in Eastern and Central Europe (Paliwoda 1995). Or else, it may centre upon the problems faced in the 'marketisation' of Eastern Europe (Yamin 1994, Hooley et al 1992, Cox and Hooley 1993). Empirical evidence suggests a tendency by western firms to enter Eastern Europe via Joint Venture agreements. Therefore, another prevalent theme is that of the criteria behind investment via Joint Ventures and the ways in which they can be successfully implemented (Nigh et al 1990, Lawrence and Vlatchoukis 1993).

Amongst the research, which seeks to address the issues of western business operation in Eastern Europe, little emphasis is given to the need to approach these markets differently to advanced economies. Pitt-Watson (1993) suggests that the direct transfer of western models and strategies may not be appropriate for these markets. However, some research pays little heed to the different demands of markets in transition. Hooley et al (1992) and Cox and Hooley (1993) compare the nature of marketing across three Central European countries. However, they use a research instrument predicated upon the assumptions of stable, advanced economies. Even after translation of the instrument into the appropriate language, many of the concepts are alien and open to misunderstanding. Other important issues may not be covered by a deductive research technique.

The difference between centrally-planned and free market economies is highlighted by a growing body of literature, within the network field. In western economies, an organisation tends to have direct relationships with its suppliers and customers, and indirect relationships with a broader range of stakeholders (Achrol, Reve and Stern 1980). However, Mattsson (1993) highlights the lack of direct channel relationships in centrally-planned economies. The main transactions were between the government and individual firms within the supply chain. He describes this as "arm's length transactions between 'faceless' buyers and sellers".

Salmi (1993) highlights the stability of networks in the administered system. This stability she relates to the clear definition of network roles and the high degree of regulation of exchange. However, De Wit and Monami (1993) point to the contrast between the stability of the previous system and the current period of metamorphosis. Some actors have disappeared, whilst others have become increasingly important. Moreover, the nature of resource flows has changed fundamentally.

There is an ongoing debate as to the nature and indeed existence of networks within the emergent markets. Snehota (1994) contends that the countries were previously hierarchies, and, as such, networks cannot be said to have existed. They may, however, offer a key contribution in the progress towards market economies.

2.7 Networks: Between Markets and Hierarchies, or Markets as Networks?

The preceding review of the literature has explored four separate strands which contribute to understanding of the entry mode choices of multinational corporations. In conclusion, this section explores the areas where the literature converges and offer complementary contributions to understanding.

A valuable, integrative rôle is played by existing inter-disciplinary considerations of entry mode choice. Buckley et al 1990 offer an integration of the international marketing and international business views of foreign market servicing. Forsgren (1989) juxtaposes the different strands of internationalisation literature presented in the preceding analysis to identify four schools of thought, which cut across disciplinary area (See Figure 2.6).

	The international firm as a hierarchy	The international firm as a coalition of interests
Strategic Behaviour as a consequence of a rational plan	Traditional Economic View of FDI	Resource-based
Strategic behaviour as a pattern in a stream of activities	The incremental view eg: Aharoni 1966 Johanson and Vahlne 1977	Non-rational Decision-making perspective eg:Johanson and Mattsson 1988

Figure 2.6 Adapted from Forsgren 1989

Casson (1994) explores the rival suggestions of an incremental process (Johanson and Wiedersheim-Paul 1975, Johanson and Vahlne 1977) or the simultaneous market entry pattern proposed by research into globalisation. This latter is based upon the argument that consumers world-wide are homogeneous (Ohmae 1990) and that, if markets differ, it is in unique ways which invalidate the benefit of cumulative international investment (Porter 1980).

In conclusion, Casson finds support for each theory. Sequential entry beginning with proximate markets is a means of deferring the high entry costs of entry into markets with high psychic distance. If the home culture of the firm is idiosyncratic, then it faces high costs in entering any international market and may do so sequentially. Simultaneous internationalisation is favoured if there is value in pre-empting competitors or if the international experience and "confidence" of managers is high. In this thesis, the firms do not come from idiosyncratic cultures. There are high levels of international experience and value in pre-empting competitors. Casson's research would imply multinational corporations would favour simultaneous entry into the countries of Eastern Europe.

Buckley and Casson (1981) also look at the dynamics of internationalisation. Three types of costs are identified: a non-recoverable set-up cost, a recurrent fixed cost relating to expenses associated with the mode of operation and a recurrent variable cost. Based on the last two of these categories, they explore the cost implications of export, licensing and direct investment and identify the optimal timing of the switch between the different modes.

The contribution of Buckley and Casson (1981) highlights am issue which runs through the literature of all disciplines, that of choosing between the alternative modes of international operation. A key part of the debate is that of whether the network is a separate mode or that markets are comprised of networks.

Jarillo (1988) contends that network literature tends towards description of the network. He ascribes this to its origins in organisational behaviour. Whilst he recognises the valuable contribution of such work to understanding of the network, he contends that the network may play an important strategic rôle.

Jarillo views the network as a choice of mode which may include shared equity ventures as well as informal co-operation. This belief derives from the definition of Thorelli (1986) that the network is a hybrid mode of organisation between hierarchy and the market (Williamson 1975):

> "For expository purposes we may think in terms of a spectrum of arrangements, from loose to tight, from arm's length bargaining to total integration, from spot transactions via standing relations to the internalisation of markets (...) at one end of the spectrum is what we may call the open market. At the other we find the firm which is relatively self-sufficient in terms of vertical or functional integration. In some ways these distinctions are analogous to Williamson's (1975) markets and hierarchies, although he would likely include as part of 'markets' a number of in-between forms where we would rather apply the generic term networks." pg. 37

This definition of the network is used by a number of works which study the choice between the network and alternative modes of operation. Lorenzoni and Ornati (1988) see 'constellations' of small firms as being developed by entrepreneurs as the most appropriate mode of operation. Miles and Snow (1986) relate the preferred mode of operation to the environment in which the firm operates. The dynamism of the network makes it the most effective organisational form in the current turbulent environment. By this argument, networks would be favoured by firms entering the turbulent markets of Eastern Europe.

Transaction cost analysis is used by a number of the works which relate to choice of organisational mode. Jarillo (1988) concludes that the choice between competing modes can be determined by the respective costs of transacting within and outside of the organisation. If an internal activity is described as an internal cost (IC), the cost of subcontracting is comprised of the external price (EP) charged by the supplier and the cost of transacting outside of the organisation (TC) and this gives the total cost of externalising the activity (EC) then:

> "an activity will be integrated (thus shaping a hierarchy) when EP + TC > IC" pg. 35

That is an activity will be internalised only if the total costs of externalising the activity are greater than those of keeping the activity within the organisation. This definition allows that the transaction costs element may be increased by the danger or "costs" of disclosing information on proprietary technologies. Therefore the external cost may be higher for firms in high technology industries or where there is a concern to protect knowledge-based assets.

Transaction costs are related to international entry mode choice by Robinson (1986):

> "it boils down to which value-added links are most likely to enjoy international economies of scale (...) if performed by external specialist firms, economies which may swamp any benefits derived from the internalisation of the transaction."

The role of transaction costs in international business is extended by the research of Klein and Roth (1990). Klein and Roth analyse the choice between four modes of export channel structure; independent distributors, joint ventures or other 'intermediate' mode, company-owned sales organisation or establishment of a subsidiary. The effects of experience and psychic distance upon the choice between these modes are analysed using transaction costs. The choice of mode is seen to be affected by the "extent to which markets operate efficiently," as the ability to externalise an activity is dependent upon the ability of the market to govern transactions efficiently. Based on these findings, Klein and Roth suggest that firms may be more likely to internalise activities in markets with high psychic distance:

> "firms should be wary of recommendations that they enter new and very unfamiliar markets with low degrees of commitment. They must also assess the extent to which their products and/or marketing activities are highly specialised and thus not amenable to a reliance on market enforcement of good behaviour from outside intermediaries. When outside enforcement cannot be relied upon, a stronger earlier commitment to the market is necessary." pg. 37

The contention of this study is that firms with high asset specificity might feel a greater need to internalise than those with low asset specificity. Klein and Roth describe this in terms of the level of familiarity of the firm with the host market. Psychic distance, by their definition relates to the perception of the market by managers in the firm. However, it relates also to the level of uncertainty in the market, particularly with respect to its legislation on protection of intellectual property and the efficiency of its market mechanisms.

Building upon the findings of this research, it would be expected that firms entering the uncertain markets of Eastern Europe would perceive high levels of psychic distance.

Moreover, the process of the transition to free market economy is at best incomplete. At worst, the likelihood of a successful outcome may be questionable. Therefore, Klein and Roth would suggest a high degree of hierarchical control.

However, the view that the network is an intermediate form is challenged in much network literature. Johanson and Mattsson (1987) claim that this view ignores some of the key characteristics of the network. They see fundamental differences between the network and transaction cost literature. In network literature, firms are viewed as mutually interdependent. In consequence, the investment processes and use of assets by one firm may be influenced by its relationships. Therefore, the network cannot simply be seen as a hybrid organisational mode which may be efficient or effective in certain circumstances. The decisions, which a firm makes, may be favoured or constrained by its existing network position (Johanson and Mattsson 1985, Mattsson 1989). Moreover, from this perspective, markets are not an alternative to networks, but rather consist of networks:

> "The markets are characterised by interaction between firms in relationships where the parties have some control over each other and the organisations are not "pure" hierarchies. To us the legal frameworks of the transactions are less important and the boundaries of the network are unclear." pg. 12

Accordingly, Johanson and Mattsson defend the focus upon network processes or dynamics. Jarillo (1988) dismisses this view as descriptive, anecdotal and as presenting networks as a "metaphor." Johanson and Mattsson contend that studying the dynamic aspects of networks may give a better understanding of "the strategies pursued by firms in such systems." Whilst the transaction cost issues of bounded rationality, opportunism, uncertainty and asset specificity are also significant in the markets as networks view, the beliefs relating to each of these differs. In particular, the dangers of opportunism are countered by its correlate trust, which the network perspective views as essential to the development of stable relationships.

The tension between the two theories is illustrated by their contradictory views of internationalisation. The internalisation view of internationalisation suggests that concern to protect a firm-specific advantage will result in the decision to create an internal market or "hierarchy." However, the network view of internationalisation challenges the belief that the firm's assets must be internal. The ability of the firm to develop internationally may reside in its relationships with other firms. Existing network "positions" may influence the decision to enter a market. Moreover, they may influence entry mode. The firm may externalise some of its activities without losing control of its crucial intangible assets.

Another vehicle for integration between the different strands of literature is offered by research into the nature of the host market. Research from a number of disciplines highlights the role of country-specific variables in influencing mode of entry. Within the economics literature, Dunning (1980) suggests that the location-specific advantages of a market may play a role in the decision whether a firm should locate its production operations there. The rational planning literature proposes frameworks and models for assessment of the risks and opportunities of target countries (Perlitz 1985, Kern 1985, Goodnow and Hansz 1972). In marketing literature, Kotler (1986) proposes the additional variables of public relations and politics, which firms may need to manage in order to successfully gain entry into blocked markets. Whilst Kwon and Konopa

(1993) highlight the fact that firms may use different modes of operation to market the same product in different countries, because of the specifcs of the host market environment. This view reaffirms the pivotal role of the Eastern European context in determining entry mode.

Research into China (Terpstra and Yu 1989, Schlegelmilch et al 1991, Cronin 1991, Johnston 1991), a country also considered to be an emerging mega-market, highlights the rôle of government control, lack of infrastructure and requirements for technology transfer in influencing entry mode. Schlegelmilch et al (1991) point to the emphasis which the Chinese government places on shared equity joint ventures as means of entry. Furthermore, they identify a predominance of large, multinational entrants in the population of firms entering China. The distinctive market environment also reduces the value of previous international experience:

> "It is worth noting that experience in other countries with similar characteristics, (notably the political régime, level of development and/or culture), does not appear to be particularly relevant in terms of lessening the intensity of problems encountered." pg. 197

At first sight, research into other planned economies might appear to offer insights into the issues faced by firms entering Eastern Europe. Whilst the countries are in the process of transition away from the centrally-controlled system, they are still characterised by many of the problems in the previous system. In researching entry into North Korea, Lee (1993) stresses that psychic distance is high and that firms must take into account the specifcs of government policy, the nature of the planned industrial system and the social issues which have arisen from punitive central control. Many of these issues abide in the transitionary economies of Eastern Europe.

However, it is clear that the entry decisions of multinational firms in Eastern Europe cannot necessarily be expected to conform to the same patterns seen in other countries. Joint Ventures might be favoured by governments within the region as a means of facilitating technology transfer. Psychic distance is high. This might either suggest low commitment entry modes (Johanson and Vahlne 1977) or that internalisation is preferred as a means of overcoming the inefficiency of the market (Klein and Roth 1990, Jarillo 1988). On the contrary, Miles and Snow might expect the turbulent environmental conditions to favour dynamic network organisational forms. This thesis proposes an inductive, theory-building approach to consideration of the influences upon entry decisions by Multinational Corporations in Ukraine, so as not to prejudge which of the valuable, but often contradictory, propositions of the literature might offer the most insightful explanation.

2.8 Propositions from the Literature

Proposition 1: High level of resources in the firm may reduce the significance of individual investment decisions

This proposition is derived from the research of Forsgren (1989), who contends that larger, more highly internationalised firms are likely to make more significant investments on entering a market. Moreover, they are more likely to skip stages. These findings are subsequently acknowledged by Johanson and Vahlne (1990) as an amendment to their 1977 research. Kutschker (1985) suggests that for demographic data, objective values may be less relevant than relative data. Thus, a firm may be influenced by its awareness of being smaller, or larger, more, or less internationalised than other firms in its industry.

Proposition 2: Models of International Investment may differ between different product or service types

A further body of literature suggests that the incremental model of internationalisation (Johanson and Vahlne 1977) may not be valid for services (Erramilli 1990) or for technical services (Sharma 1989). Reid (1983) concludes that the model is too deterministic and general and that firms may behave differently, depending on industry sector and the specifics of the situation.

Proposition 3: Subsidiaries may play a significant role in the international investment decisions of multinational corporations

Forsgren (1989) also suggests that the decisions made by larger, more internationalised firms may be significantly influenced by their subsidiaries. Hence investment decisions need not come from the centre of the organisation, but may be initiated by local or geographically-proximate subsidiaries. This contention also informs the further proposition of this research:

Proposition 4: Investment decisions may be routed via geographically proximate subsidiaries

Proposition 5: Experience of similar markets allows firms to generalise and reduces perceived risk

In proposing the incremental model of internationalisation, Johanson and Vahlne (1977) build upon the views of Penrose (1959) that market knowledge must be direct and experiential. According to this belief, psychic distance, which is high on entry into a new international market can only be overcome by direct experience of that market. It cannot be transferred by use of experienced staff or knowledge external to the firm. However, after criticism of these views by Forsgren (1989), Johanson and Vahlne accept (1990) that knowledge gained in similar markets may be transferred within the firm.

Proposition 6: High levels of environmental uncertainty increase the perceived risk of investment in a country

Studies of market attractiveness (Kami 1976, Paul et al 1976) stress the role of environmental uncertainty in increasing the risks of operation in a market. Transaction cost analysis highlights uncertainty, together with the bounded rationality of managers (Williamson 1981) as factors which increase transaction costs. Discontinuous change, such as that encountered in Ukraine may invalidate use of rational planning techniques to assess the level of risk, which firms face (Edwards and Harris 1978).

Proposition 7: High levels of environmental uncertainty increase the perceived risk of investment in a country

Thomas (1994) contends that the transition process in Eastern Europe is unparalleled. Therefore, it cannot be assumed that theories, based on empirical evidence gathered in stable advanced economies, will be applicable in considering investment decisions in the region. Research into other emerging markets (Schlegelmilch et al. 1991) concludes that the variables, which they include in their study play only a minor role. Therefore, it is proposed that research must be inductive, in order that it does not prejudge the variables, which explain the entry choices of multinational corporations in Ukraine.

Proposition 8: Factor advantages increase the attractiveness of Ukraine for investors

In the economics literature, location-specific advantages, such as the availability of raw materials, or low labour costs are seen to provide the impetus for entry into new international markets (Dunning 1982, Rugman (1989).

Proposition 9: The decision to enter or expand in Ukraine may be influenced by the actions of oligopolistic rivals

Similarly, from the economics literature, comes the contention that the actions of firms may be defensive reactions to the entry into a market by an oligopolistic rival (Knickerbocker 1973).

Proposition 10: The decision to enter or expand in Ukraine may be influenced by the actions of existing customers or suppliers

The interaction and network literature supports the view that the activities of the firm cannot be viewed atomistically. Existing relationships with suppliers and customers (Håkansson 1982, Turnbull and Cunningham 1981), or with other stakeholders in the environment, can influence the firm's actions. Johanson and Mattsson (1988) suggest that highly internationalised firms may be concerned with building positions in global networks and may use existing domestic and international relationships in order to do so. Related to this contention, is the belief that knowledge is a scarce resource, which can be exchanged within relationships. In the conditions of high market uncertainty in Ukraine, the need for information exchange may prompt the development of new relationships:

Proposition 11: The knowledge of a market on which decisions are built may come from the network of relationships, which the firm has with other firms or key stakeholders in the Ukraine.

Chapter 3 - Methodology

3.1 Introduction

It has been suggested (Easterby-Smith et al 1991), that the choice of methodology is influenced by the researcher's own preferences, by the nature of the research question and by the pragmatic concern of access. As an introduction to the research methodology for this thesis, it may be appropriate to address these issues.

The researcher's background is in the field of international marketing. The last decade has witnessed an ongoing debate over the future of research within the marketing area. The pre-eminence of quantitative, positivist studies has opened the discipline to the charge of "New Marketing Myopia" (Brownlie et al 1994). In the early 1980's, Day and Wensley (1983) suggested that the way ahead for marketing literature may be to adopt a more strategic focus. However, Hunt (1994) contends that marketing has made little contribution to the strategy debate in the intervening decade. Moreover, despite the undoubted value of qualitative research methodologies for in-depth research, marketing literature is still focused upon theory-testing rather than theory building (Bonoma 1985, Desphande 1983). Desphande claims:

> "Marketing scholars have too long ignored the meta-theoretical implications of reliance on a single paradigm. This paradigm has been identified as that of logical positivism. In its exclusion of a more qualitative paradigm, marketing theory has developed certain inherent methodological biases. These biases come from developing new theoretical contributions while using methodologies more appropriate to theory testing than to theory generation."

Nowhere does a focus upon deductive methodology present more of a problem than in research into Eastern Europe. The question addressed by this research is "what influences the choice of entry mode of multinational corporations in conditions of high market uncertainty?" As can be seen from the preceding review of the literature, contributions to understanding of this question can be gained from the fields of marketing, strategy, economics, organisational behaviour and international business. Accordingly, an inter-disciplinary approach is required. It is hoped that the findings of this research will be of relevance within the fields of strategy and international business, as well as to that of marketing. Given the unparalleled nature of the transition process in Eastern Europe (Thomas 1994, Egan 1993), the chosen methodology must not prejudge which of the theoretical contributions of these fields, if any, will be applicable.

The reasons for the choice of the Ukraine as the empirical basis of the study are two-fold. Firstly, Aharoni (1966) contends that entry decisions must be considered in their context. Each market in Eastern Europe is at a different stage of transition, and the uncertainty of its situation rests upon different concerns. Therefore, for this in-depth study, focus upon entry into one market is preferred. This market must be characterised by high levels of environmental uncertainty. Ukraine meets this requirement. Moreover, at the time of its selection in early 1993, Ukraine was the target of significant investment activity by multinational corporations. However, the intervening period has seen a worsening economic crisis, which has raised the question of whether it is likely to succeed in its transition to free market economy.

Secondly, Warwick Business School is a partner in an EC Technical Assistance to Commonwealth of Independent States (TACIS) project with the International Management Institute in Kiev. Given that travel to Ukraine was required by the role of Warwick's marketing team member, Ukraine was judged to be a good market to study, as additional time could be added onto visits for fieldwork.

This chapter considers the challenges posed by research into uncertain markets and reviews the research design.

3.2 Choice of Methodology

The research question is inter-disciplinary and draws upon a complex field of possible variables. It involves the study of entry decisions in an uncertain and unprecedented market situation. Moreover, the decisions of firms may be influenced by their relationships with their competitors, customers, suppliers and other stakeholders in the environment. The methodological consequences of these facets of the research question are explored below.

3.2.1 Inter-disciplinary

Research into marketing accords most closely with the positivist world view. Hirschmann (1986) highlights the fact that only one non-positivist, empirical study featured in Journal of Marketing in the preceding three decades. The predominance of the "philosophy of science" in marketing is indicated by the norms of empiricism, causality and quantification which guide much of its research. Hirschmann attributes these to its origins in economics.

Easterby-Smith et al (1991) give a composite list of methodological assumptions which are linked with positivism. Whilst this list is more than Comte (1853) originally proposed, it includes features which Easterby-Smith et al see as having become associated with it (See Figure 3.1). Adherence to all, or part, of these assumptions predisposes research in the field to progress in a theory-testing rather than theory-building direction (Bonoma 1985, Desphande 1983).

Indeed, the dominance of positivism has caused considerable concern within the marketing field. The debate is complex. For the past decade, Anderson and Hunt have argued the merits of critical relativism (Anderson 1983), versus critical realism (Hunt 1983). A number of reservations have been expressed about the latter. The shift in the nature of marketing towards a more socially-constructed discipline is seen to require a more humanistic approach (Hirschmann 1986). Moreover, emphasis upon quantitative, rather than qualitative, research may act as a disincentive to tackling interdisciplinary or complex questions (Anderson 1983, Easton 1993, Egan 1993, Hunt 1994).

Independence	*the observer is independent of what is being observed*
Value-freedom	*the choice of what to study and how to study it can be determined by objective criteria rather than by human beliefs and interests*
Causality	*the aim of social sciences should be to identify causal explanations and fundamental laws that explain regularities in human social behaviour*
Hypothetico-deductive	*science proceeds through a process of hypothesising fundamental laws and then deducing what kinds of observations will demonstrate the truth or falsity of these hypotheses*
Operationalisation	*concepts need to be operationalised in a way which enables facts to be measured quantitatively*
Reductionism	*problems as a whole are better understood if they are reduced into the simplest possible elements*
Generalisation	*in order to be able to generalise about regularities in human and social behaviour it is necessary to select samples of sufficient size*

Figure 3.1 Source: Easterby-Smith et al 1991

This thesis does not reject the value of seeking to generalise from hypotheses, nor of seeking to explain the antecedents of interesting phenomena. However, it tends to the view of Bonoma (1985), that there remains a need for preliminary "theory-building" to advance the theoretical development of the field.

The need for pluralism of philosophical views and methodological approaches has been recognised in a number of fields of social science. Van Maanen (1983) expresses strong concerns over the predominance of deductive techniques in the organisational theory field (1983):

> "Questions have been raised about the extent to which our methods are guiding our theory and concern has been expressed about the degree to which our procedures have become so ritualised that the necessary connection between measure and concept has vanished."

However, subsequent research in the field suggests a trend towards qualitative, inductive methodologies (Easterby-Smith et 1991). Piore (1979) suggests that qualitative research methodologies can add value to the economics field, traditionally dominated by quantitative and deductive research. Day and Wensley (1983) propose that the marketing discipline requires a more strategic stance. This, in turn, may require a broader, inter-disciplinary approach to answering research questions.

The extant research in the field of international investment decisions spans economics, finance, strategy, marketing and organisational behaviour. Consequently, it is important that the chosen methodology can comprehend and build upon the considerable body of literature which exists in these fields. Moreover, it must be able to identify factors which play a role in investment decision-making, whatever their field of origin. Accordingly, this thesis attempts to build upon relevant theories from a number of fields, in order to gain a better understanding of the research question.

3.2.2 Complex

Bonoma (1985) suggests that choice of methodology should be influenced by the level of understanding, which already exists in a field. If there is "poor" theory-development, then "premature application of theory-testing normal science methods" is inappropriate.

There is a significant amount of research into international investment decisions. The majority involves study of a small subset of the variables proposed by the literature (Dunning 1980, Johanson and Vahlne 1977). Whilst this reduces the complexity of the field to a manageable level, Bonoma recognises an inherent danger in such studies in that: "the conclusions can contain no more information than is contained in the premises". Moreover, they can tend towards giving a numerate description of qualitatively complex phenomena (Van Maanen 1983). A major limitation of broad, generalisable studies is that they cannot explore the richness of the data.

There is a relative dearth of literature which tries to synthesise the findings of the diverse disciplinary perspectives. A key challenge for such studies is the complexity and breadth of the range of variables proposed for inclusion. It is not always clear which are dependent and which independent. Many variables appear to be inter-related. Either composite variables or proxy measures may be required to study some of the softer issues. Use of a generalisable, quantitative study is next to impossible. Preferred techniques for complexity reduction, such as factor analysis, require a questionnaire so long, that a sufficiently high response rate is unlikely. Moreover, in multinational corporations, identifying respondents involved in the decision is difficult.

The alternative approach to handling this level of complexity is to use a methodology which does not seek to generalise, but rather to gain an in-depth understanding of the issues. Use of an "intensive" rather than an "extensive" methodology is suggested (Wilson 1993). Harrigan (1983) contends that for strategy research, methodologies can range from the "fine-grained" to "broad-grained. " The decision of which to use should be contingent upon the complexity of the question (See Figure 3.2)

Fine-grained Methodologies <---	---> Broad-grained Methodologies
Captures nuances, detail of context; shows improved understanding of forces underlying phenomenon in each observation; no generalizability	Generalizable, statistical significance; little knowledge of interacting forces within each observation; occasional missing of important contingencies

Figure 3.2 Source: Harrigan 1983

The trade-off between the depth of the research methodology and the generalisability of the findings is acknowledged. However, fine-grained research methods can provide an understanding of complex issues which "broad-grained" approaches cannot. Van Maanen (1983) suggests that fine-grained, qualitative techniques are best used:

> "to describe, decode, translate and otherwise come to terms with the meaning, not the frequency of certain more or less naturally-occurring phenomena."

Fine-grained, qualitative techniques seem most applicable for this research.

3.2.3 Context-Specific

Intensive research methodologies are also proposed as a way of studying strategic issues in their context. Bonoma (1985) refers to the existence of phenomena which "cannot usefully be studied outside the context in which they naturally occur". Harrigan (1983) relates the concept of fine-grained methodology to study of issues in their context. This juxtaposition accords with the contention of Aharoni (1966) and Pettigrew (1985b) that strategic decisions cannot meaningfully be studied outside their context. Hence, the most appropriate methodology for this research should be in-depth, qualitative and contextual.

Additional weight is lent to this argument by the nature of the decisions to be studied in this research. Much of the extant literature into international investment decisions does not look at the issues in their specific country context. In this instance, there are compelling reasons for doing so. Empirical evidence suggests that models of international investment decisions are not universally applicable (Dichtl et al 1984). Models might, at the limit, be generalisable for stable market situations (Johanson and Vahlne 1990). Yet, there are a number of firm-specific issues which they do not take into account (Aharoni 1966, Cyert and March 1963, Hickson et al 1986). Aharoni (1966) contends that foreign investment decisions cannot be viewed as single incidents:

> "We view decision-making in complex organisations as emerging from a continuous social process, composed of many small acts, and carried out by

> different people at divergent points of time. We reject the notion that one isolated decision can be made the focus of analysis. Instead, we suggest concentration on the dynamic social process in which activities are carried out, policies are formulated and solutions to specific problems emerge."

The value of studying decisions as part of a larger process within the firm, lends weight to the argument that a qualitative, contextual approach is preferable as:

> "Qualitative researchers are more likely than quantitative researchers to confront the constraints of the everyday social world. They see this world in action and embed their findings in it." (Denzin and Lincoln 1994)

Qualitative research may still use the hypotheses and terminology of positivism (Yin 1983). In this research, however, it is suggested that the use of hypotheses makes untenable assumptions about the key influences upon decisions. The preferred approach is nearer to grounded theory, as proposed by Glaser and Strauss (1967). Grounded theory is defined by Glaser and Strauss as "the discovery of theory from data" which can help to "forestall the opportunistic use of theories that have dubious fit and working capacity".

This does not imply a strongly phenomenological philosophy. The field of variables, which might be included, is so broad that some structure must be imputed. Hence, the literature review in the preceding chapter generates a series of propositions (See Section 2.8), which are used as the basis of a semi-structured research instrument. The relative importance of these is discovered by analysis of the data. Thus, development of hypotheses is the *aim* rather than the *basis* for the research. Glaser and Strauss emphasise:

> "generating a theory from data means that most hypotheses and concepts not only come from the data, but are systematically worked out in relation to the data in the course of the research. Generating a theory involves a process of research."

The specifics of how grounded theory is used in practice are acknowledged to vary (Strauss and Corbin 1994). In the sense that it suggests an inductive, iterative and reflexive research process, it is adopted in this thesis, as a way of overcoming the danger of prejudging what is theoretically important in the Eastern and Central European context.

3.2.4 Interconnected Units of Analysis

The unit of analysis for this research is the decision to enter, expand or exit from the Ukraine. However, from both oligopolistic reaction and network theories, it can be seen that decisions may not be independent, but may be affected by the actions of actors outside of the firm. Moreover, in some cases, firms made more than one decision during the period of data collection. This accords with Aharoni's view (1966) that studies of a single decision out of its context may overlook important influences.

The issue of interconnectedness is addressed by Easton (1993), who stresses the inherent complexity of network structure. This is an inevitable consequence of changes in membership, developing relationships, differences in the size and power-dependence of firms, and direct and indirect links, involving different types of exchange. Easton concludes that, as they are embedded in network structures, individual firms cannot be viewed as independent units for statistical analysis. Network boundaries are difficult to determine. Units may be of different sizes. Sampling techniques rely on the independence of the sampling unit. As the unit of analysis is not, in the strictest sense, independent, then he contends that it is inappropriate to use theories of statistical inference. Knoke and Kuklinski (1982) support this view:

> "At present, the bases for statistical inferences from network data are poorly understood, and we can only advise cautious use and hope that the problems will eventually be resolved."

Regardless of whether statistical techniques are used, delimiting the boundary of the network is a key issue for research design. In this thesis, the view of Cunningham and Culligan (1991), that ties need to be of a certain "strength" to be relevant, is adopted. A focal firm approach is taken, which looks at an individual firm, but studies it in conjunction with its principle relationships.

3.3 The Use of Case Studies

The need to study decisions *in context*, for *interconnected units of analysis*, using an *in-depth* methodology *inductively* combines to present a compelling argument in favour of the use of case studies for this research. Definitions of the case study range from those, which suggest that "case" is synonymous with observation in a quantitative study (Abbott 1993), to the majority view, which sees the case study as a means of studying a problem in-depth and in its context. (1983) Yin defines the case study as

> "an empirical enquiry that investigates a phenomenon within its real life context; when the boundaries between phenomenon and context are not clearly evident; and in which multiple sources of evidence are used."

He sees it as being applicable to answering "how" or "why" questions about a contemporary event, or events, over which the investigator has little, or no, control. Ragin (1993) identifies different types of case study. The case might be specific, referring to a particular person or incident, or more general, referring, perhaps, to the firm or family. The distinction between specific and general is plotted against the objectivist or subjectivist philosophies to arrive at four ways of understanding cases (See Figure 3.3). Ragin believes that these positions are not mutually-exclusive, but represent a framework for understanding the aims of different types of cases.

	Case Conceptions	
Understanding Cases	Specific	General
Empirical Units	1. Cases are found	2. Cases are objects
Theoretical Constructs	3. Cases are made	4. Cases are conventions

Figure 3.3 *Conceptual Map for answers to "What is a Case?"* Source: Ragin 1993

This research focuses upon the decision by multinational corporations (MNCs) to invest in, expand, or exit from Ukraine. It explores the influences upon these decisions and the stakeholders, who play a role in them. If this study were positioned on the Ragin grid, it would tend to the view that cases are empirical units. This research begins with a process, international decision-making, which it studies within a conventional context, the organisation. Therefore, it fits most neatly in Cell 2. However, the decision may involve actors outside the focal firm. For this reason, the process may transcend the boundaries of the firm, in a way more reminiscent of Cell 4.

The traditional criticisms, which are levelled at case study research, are that it is anecdotal and lacking in rigour. Therefore, the design of case-based research must address the problems of construct validity, external and internal validity and reliability (See Figure 3.4).

Construct Validity	*establishing correct operational measures for the concepts being studied*
External Validity	*establishing the domain to which the study's findings can be generalised*
Reliability	*demonstrating that the operations of a study, such as data collection procedures, can be repeated with the same results*
Internal Validity	*establishing a causal relationship whereby certain conditions are shown to lead to other conditions*

Figure 3.4 Source: Yin 1983

To ensure it's rigour, this research uses the structured approach proposed by Eisenhardt (1989), whose framework (See Figure 3.5) builds upon the work of Yin (1983), in case study design, and Miles and Huberman (1984), in data analysis. It is used in this chapter to highlight the key methodological issues in the research design.

3.4 Getting Started

3.4.1 Developing Theory

The research question was derived from preliminary review of the literature. Whilst this research does not wish to exclude variables, which may be relevant to the question, data collection required some structure to ensure the reliability of the case studies.

Process of Building Theory from Case Study Research

Step	Activity	Reason
Getting Started	Definition of Research Question	Focuses Efforts
	Possible a priori constructs	Provides better grounding of construct measures
	Neither theory nor hypotheses	Retains theoretical flexibility
Selecting Cases	Specified Population	Constrains extraneous variation and sharpens external validity
	Theoretical not random sampling	Focuses efforts on theoretically useful cases i.e.: those that replicate or extend theory by filling conceptual categories
Crafting Instruments and Protocols	Multiple Data Collection Methods	Strengthens Grounding of theory by Triangulation of evidence
	Qualitative and Quantitative data combined	Synergistic View of Evidence
Entering the Field	Overlap Data collection and analysis, including field notes	Speeds Analysis and reveals helpful adjustments to data collection
	Flexible and opportunistic data collection methods	Allows investigators to take advantage of emergent themes and unique case features
Analysing Data	Within Case Analysis	Gains familiarity with data and preliminary theory generation
	Cross-case pattern search using divergent techniques	Forces investigators to look beyond initial impressions and see evidence through multiple lenses
Shaping Hypotheses	Iterative tabulation of evidence for each construct	Sharpens construct definition, validity and measurability
	Replication logic	Confirms, extends and sharpens theory across cases
	Search for evidence of 'why' behind relationships	Builds internal validity
Enfolding Literature	Comparison with conflicting literature	Build internal validity, raises theoretical level and sharpens construct definitions
	Comparison with similar literature	Sharpens generalisability, improves construct definition and raises theoretical level
Reaching Closure	Theoretical Saturation when possible	Ends process when marginal improvement becomes small

Source: Eisenhardt 1989 p 533

Figure 3.5

Consequently, a set of propositions were derived from the literature review to provide the basis of the study (See section 2.8). The propositions are shown in conjunction with the variables, which may provide insights into them (See Figure 3.6).

Variables	*Propositions*
Firm Size	*1. High levels of resources in the firm may reduce the significance of individual investment decisions* Forsgren 1989; Johanson and Vahlne 1990
Product/Service Type	*2. Modes of international investment may differ between different product or service types* Erramilli 1990; Sharma and Johanson 1987
Ownership	*3. Subsidiaries may play a significant role in international investment decisions in MNCs* Forsgren 1989; Andersson et al 1990
	4. Investment Decisions may be routed via geographically- proximate subsidiaries Forsgren 1989
International Experience	*5. Length of international experience may reduce perceived risk of an investment decision* Forsgren 1989
E./C.European Experience	*6. Experience of similar markets allows firms to generalise and reduces perceived risk* Forsgren 1989; Johanson and Vahlne 1990
Psychic Distance	*7. High levels of environmental uncertainty increase the perceived risk of investment in a country* Johanson and Vahlne 1977; Goodnow and Hansz 1972 Klein and Roth 1990
	8. Traditional frameworks for assessing market attractiveness cannot explain the current pattern of investment in Ukraine Johanson and Vahlne 1977; Egan 1993, Kami 1976 Paul et al 1976
Location-Specific Advantage	*9. Factor advantages increase attractiveness of markets for investors* Dunning 1980, 1988; Rugman 1989
Criteria for investment	*10. Decision to enter or expand in Ukraine may be influenced by the actions of oligopolistic rivals* Knickerbocker 1973, Buckley and Casson 1976

11. Decision to enter or expand in Ukraine may be influenced by the actions of existing customers and suppliers Johanson and Mattsson 1988

12. The knowledge of a market on which decisions are built may come from the network of relationships which a firm has with other firms or with key stakeholders in the Ukraine
Johanson and Mattsson 1988

Figure 3.6

These variables were converted into a semi-structured interview format. More than one question was used to probe each area. Demographic data were obtained for all firms. However, respondents were allowed to place their own emphasis on the questions relating to the influences upon their investment decision. In this way they gave insights into the specifics of their situation and an assessment of which they considered to be important issues. This was felt to be a more reliable means of determining the "strategic agenda" for the decisions, than use of more formal hypotheses and theory-testing.

Yin (1983) suggests that the process of data collection, for case study research, is not parallel, but sequential. Data are not collected at one point in time, as with a mail survey. Rather, each case study is built up from a series of interviews. Each successive case is written with a knowledge of the findings of previous cases. It is a cumulative process. As interviews were completed, the data were analysed to check whether additional areas were consistently referred to. This might suggest the exclusions of significant questions. The definitive list of questions is shown in Figure 3.7.

Not all questions were relevant in each case, or the respondent did not feel in a position to answer fully. The former did not represent a significant difficulty. The interviewee was allowed to place the emphasis, where they wished. This gave useful insights into the importance they attached to issues. If a question was relevant to the firm, but the respondent did not feel in a position to answer, this was often compensated by the suggestion of an additional respondent.

Firm Size	Turnover Number of Employees
Product/Service Type	Industry sectors and product types of firm
Ownership	Type of organisation structure Who made the decision to invest?
International Experience	Number of countries in which firm has invested What type of operations do they have in these? Percentage of sales overseas Number of years of international experience
East or Central European Experience	Number of Eastern or Central European countries in which the firm operates Mode of operation in these? Chronology of entry into different countries Pattern of investment/expansion in these
Environmental Stability	What are the greatest opportunities and risks? Sources of information used to monitor changes?
Location-Specific Advantage	What was the motivation for market entry?
Criteria for investment	What was motivation for market entry? On what basis would investment be judged successful?
Level of investment	Why choose this mode of operation? Conditions for further investment? Is this likely?
Influence of competition	What are competition doing in market? Who entered market first? What modes of operation do competitors have?
Influence of customers/ suppliers	Answered under criteria for investment. If yes, how long has relationship existed? Has this influenced entry into other markets?
Sources of Information	What sources of information were used to assess risks and opportunities of entering Ukrainian market? What sources are used to monitor changes in the environment? How useful are embassies, trade missions etc.?
Stakeholders	Who are the key stakeholders in the market? What are the relationships with these? What do they perceive to be the problems and opportunities of operation in Ukraine?

Figure 3.7

3.5 Selection of Cases

3.5.1 Replication Logic

Yin (1983) contends that case study research should not seek to generalise on a numerical basis, as would survey-based quantitative research. Rather, he proposes that case study research should use "analytic generalisation" to ensure external validity. Multiple case studies are not intended as a statistically valid sample of a population, but to provide replications

> "Which [seek] convergent evidence regarding the facts and conclusions for the case; each case's conclusions are then considered to be the information needing replication by other individual cases"

He distinguishes between two types of replication: *theoretical replication*, which selects cases which vary against key variables and *literal replication* which chooses cases which are the same on critical dimensions. In this research, the theoretical replications were between firms in different industry sectors, and the literal replications were from within each sector.

3.5.2 Selection of Cases by Sector

Initially, fifteen investment decisions were studied. Thirteen of the decisions were to invest in the Ukraine, two involved the decision not to invest. During the period of data collection, five additional decisions were made. The additional decisions varied from that of investing further, to that of not investing further, or even withdrawing from Ukraine. The total number of decisions studied was twenty:

Initial Decision			*Subsequent Decision*		
No Investment	Initial Investment	Further Investment	No further Investment	Reduction in Investment	Withdrawal
2	**13**	**2**	**1**	**1**	**1**

Figure 3 8

As in five cases, more than one unit of analysis was embedded within the same firm, the case design corresponds to Yin's Multiple embedded design (See Figure 3.9)

	Single-Case Design	*Multiple-Case Design*
Holistic (Single Unit of Analysis)	Type 1	Type 3
Embedded (Multiple Units of Analysis)	Type 2	Type 4 *** Preferred Case Design**

Source: Yin (1983)

Figure 3.9

The choice of sectors, from which the cases were drawn, was influenced by the pragmatic issue of sectors in which Western firms were well-represented. However, additional criteria which determined the selection of cases were:

- Had invested or were considering investment in Ukraine
- More than one firm in the sector was represented in Ukraine, so that inter-firm comparison was possible
- Access to both Western and Ukrainian members of the Decision-Making Unit
- Situated in the vicinity of Kiev

The original information on which firms were operating in Ukraine came from the DTI Overseas Information Service in London. Additional information was later obtained from the Commercial Attaché of the British Embassy in Kiev. Listings of foreign investments in Ukraine were also received from the US, Canadian, French, Belgian and German embassies.

Whilst a number of small entrepreneurial firms were found to be operating in Ukraine, the decision was made to focus upon the multinational firms. There were three reasons for this choice. Firstly, a large proportion of the investments involved multinational firms. Secondly, both the western and Ukrainian side of the investment could be studied in cases of multinational firms. Finally, a number of theories are seen to be less relevant for firms, which are already highly internationalised (Johanson and Vahlne 1990, Forsgren 1989, Johanson and Mattsson 1988), therefore these were potentially interesting cases. Multinational corporations in the following sectors were researched:

Financial Services
Household Consumables
Computing
Chemicals
Tobacco

During the period of research, the researcher's network of contacts developed, such that one respondent might suggest another firm, which they felt to be interesting. Cases in three additional sectors were added as a result of such contacts. These were in telecommunications, law and drinks. Only one case was researched in each of the last three sectors. Access could have been gained into others, however this was less of a constraint than time. Moreover, the context changed so significantly over time that comparability between new and old cases became difficult (See Section 3.8.2). The cases can be split by industry as follows:

	Number of Cases	*Total*
Business-to-Business Service		*6 cases*
Financial Services	5	
Law	1	
Consumer Goods Firms		*4 cases*
Tobacco	1	
Drinks	1	
Household Consumables	2	
Industrial Goods Firms		*5 cases*
Computing	1	
Chemicals	3	
Telecommunications	1	

Figure 3.10

As respondents were assured of confidentiality, cases are not identified by name in the main body of the analysis. However, a full list of respondent firms is provided below.

Arthur Andersen
BP
Coopers & Lybrand
Ernst & Young
GPT
ICI
ICL
Johnson Wax
Mazars Formation
Price Waterhouse
Procter & Gamble
Rothmans
Salans, Hertzfeld and Heilbronn
Seagrams
Shell

In the analysis chapters, the cases are identified alpha-numerically by industry and firm. The law, tobacco, drinks, computing and telecommunications firms were not separated into different industries, as they would have been uniquely identified. Moreover, preliminary analysis showed that these cases could be compared with other industries as literal, rather than theoretical, replications (See chapter five). Hence, the firms were split into the following groupings:

Industry Sector	Letter	Number of firms
Financial Services/Law	A	1 - 6
Tobacco/Drinks	B	1 - 2
Household Goods	C	1 - 2
Chemicals	D	1 - 3
Computing/ Telecommunications	E	1 - 2

Figure 3.11

3.5.3 Size of Firms

The size of the firms was measured by number of employees and financial turnover. Some data was obtained from company reports and interviews. However, to ensure the comparability of data, a single source was used. The source of secondary data used was Hoovers' Handbook of World Business (1993). This provided data for the largest number of the cases studied. Supplementary data were drawn from Datastream On-line service and from Stopford's Directory of Multinationals (1992). From this data, firms can be classified by the range of size and by mean value.

Turnover

Mean Value $21 193 million
Range $2,624 million to $102,697 million

Employees

Mean Value 57, 319
Range 100 to 133,000

3.5.4 Degree of Internationalisation

The same sources were used to obtain data on the degree of internationalisation of the firms. The variables used to assess the degree of internationalisation were the number of countries, in which a firm had investments, and the percentage of it's sales, which were outside the home country. The choice of data on investments, rather than countries to which the firm exports, was based on availability of data. Data were not always available for the total number of countries, in which firms operated. However, often they included a list of the countries in which they had investments. Similarly, percentage of sales, rather than assets, was used because of differences in international accounting conventions. Whilst North American accounts give percentage of assets overseas, UK and European accounts tend to give only total assets. The percentage of sales data were more widely available.

Full data on size and degree of internationalisation are given in Appendix 2.

3.6 Crafting Instruments and Protocols

3.6.1 Multiple Sources of Evidence

To ensure the reliability of the research, data were drawn from multiple sources. Within individual case studies, interviews were held in both the Western and Ukrainian operation, where this was feasible. Resource limitations made it impossible to interview some respondents. In some cases, the decision was made in the US Head Quarters, or in a European subsidiary. Six cases were studied from both ends of the decision. Also, where possible, more than one respondent was drawn from within both the western and Ukrainian operation. However, in some instances, there was only one person who had been involved in the decision to enter.

Deeper understanding of the Ukrainian context, especially of the country-specific issues facing western firms operating in the market was gained by review of market research and press coverage and from interviews with key stakeholders. Additional data were drawn from:

Ukrainian firms:
Leninskaya Kuznitsa Shipyard, Ukrainian Financial Group, DLD International

Ukrainian Stakeholders:
Chernobyl Union; President's Representative of Podol region, Kiev.

Educational Institutes in Kiev:
International Management Institute, Kiev; Kiev Polytechnical Institute; Kiev Economic University; International Christian University, Kiev. Interviews and working over a period of eighteen months with staff and students of IMI-Kiev; Harvard University's PERU (Project for Economic Reform in Ukraine.

Student projects with twelve additional firms considering investment in Ukraine. Identities are subject to a confidentiality agreement.

Western stakeholders:
British Embassy; US Embassy; Belgian Embassy; British Council; American Chamber of Commerce; EC TACIS Kiev and Brussels representatives; co-ordinator of EC "alimentation-Kiev" project; three respondents from IFC (subsidiary of World Bank); US Peace Corps volunteers working in Kiev; partners in EC TACIS scheme; partners in parallel EC TACIS scheme;

These categories of respondents have also been coded, as follows:

Type of respondent	Code	Number of respondents
Ukrainian firms	F	1 - 3
Ukrainian stakeholders	G	1 - 2
Educational Institutes in Kiev	H	1 - 5
Student Projects	I	1 - 4
Western Stakeholders	J	1 - 16

Whilst only one interview was held in some of these categories, collaboration with co-workers on the EC TACIS scheme and with staff and students at Kiev's International Management Institute provided a far fuller immersion in Ukraine as a participant observer, teacher and colleague. Indeed, involvement in the TACIS scheme has provided opportunities for frequent visits to Ukraine, often during historic times such as the build-up to the March 1994 elections, and also the pleasure of hosting visits by Ukrainian colleagues to the UK.

3.7 Entering the Field

3.7.1 Data Collection

Finding appropriate interviewees initially seemed difficult. Within a complex organisation, it was difficult to identify the individual, or individuals, who had been involved in decision to enter Ukraine. The task was made easier by the possibility of interviewing in Ukraine, where lists of subsidiary managers were available from embassies or trade bodies. From an initial interview with the Country Manager or representative of the firm in Ukraine, a list could be obtained of those, who had been involved in the entry decision. Face-to-face interviews varied in length between one and four hours. The average interview length was approximately one hour and twenty five minutes.

Data pertaining to entry decisions were collected in July and November 1993. However, by late 1993, it became apparent that the dramatically worsening market conditions in Ukraine were raising problems for the comparability of data. The full ramifications of these worsening market conditions is explained in the next section. One consequence, for data collection, was the addition of a further phase of interviews. Update interviews with all previous respondents were held in March 1994. The cut-off point for data collection was the Presidential Elections in Ukraine, in late March 1994.

3.8 Analysing Data

3.8.1 Preliminary Analysis of Data

Internal validity is defined by Yin (1983) as the process of establishing the causal links within research. Whilst this research is exploratory, the aim is to highlight explanatory variables for the investment decisions made by multinational corporations. These variables were identified by a process of data analysis. Verbatim notes were taken during interviews. Such was the sensitivity of discussing entry strategies, that a number of firms were reluctant to allow interviews to be recorded. Taking notes resulted in the loss of some detail of the responses. However, this was compensated by fuller and more candid responses.

Interview notes were transcribed, as soon as possible after each interview. The data were then coded under the variables used in the semi-structured research instrument. Under each heading, data were split into direct and indirect responses to the question. Direct responses were objective data such as length of experience, or date of entry into the market. Indirect, or non-codable data, were additional points raised by the respondent, which elaborated on, or qualified, the response. For each interview, an "Other Information" category was created to capture information, which did not fit neatly under one of the other headings.

After each interview was coded, the data were compared with that of previous interviews. Similarities and differences were identified within each case and between literal and theoretical replications. These allowed for identification of convergent and divergent patterns of behaviour. Variables were identified which appeared to explain such similarities and differences.

3.8.2 Time Series of Data

The reality of carrying out research, in a rapidly changing context, raised challenges both for data collection and data analysis. Such was the rapidity of change in Ukraine in 1993, that the context surrounding a later case was very different to that in earlier cases.

In studying the entry decisions of multinational corporations in Ukraine, the date on which data were collected played a significant role in determining its content, in that the responses altered with positive and negative changes in the environment. Data on entry decisions were primarily collected in July 1993. Interviews, with respondents in the UK and France, were carried out during the summer and autumn of 1993. The concluding interviews on entry decisions were carried out during a visit to Ukraine in November 1993.

In November 1993 the magnitude of the negative changes in Ukraine was so great, that two firms, who had been speaking of criteria for expansion in July 1993, were now speaking of possible withdrawal from the market. Hence concern arose as to the comparability of data collected earlier and later in this period. Moreover, in November 1993, additional issues, such as criteria for withdrawal from the market were frequently cited, which had not been on the strategic agenda in July 1993. It was apparent that researching markets, subject to discontinuous change, required attention to its methodology, in order to overcome problems posed by that very discontinuity. Three main consequences arose from the contextual changes. Firstly, two additional questions were added to the research instrument. These were

> *On what basis would the firm decide to withdraw from the Ukraine?*
> *Who would make that decision?*

Secondly, in March 1994, an additional phase of interviews was held with at least one respondent from each firm, in order to identify any changes in the firm's responses since the initial interview. In fact, only two of the firms interviewed in July 1993 had changed their views to any significant extent. Therefore, cross-case analysis was still felt to be possible.

However, as a final consequence of the changes, it was decided that no new cases should be added to the study. Every time a new case was added, a further round of interviews would have been required with the existing cases. Moreover, it was decided that data should be analysed against the context of the time. Therefore, attention was paid to ways in which the Ukrainian context could meaningfully be analysed (See Section 4).

3.9 Shaping Hypotheses

Eisenhardt proposes that data analysis should involve a process of within and across-case analysis to seek patterns. Yin (1983) suggests data analysis is an iterative process, which can begin in parallel with data collection. Iterative tabulation of data is suggested as a way of advancing the process of data analysis towards formulation of hypotheses. It is suggested that these hypotheses are tested in later case studies. The suggestions of Eisenhardt and Yin were adopted in this thesis.

In chapter four, the Ukrainian market environment is analysed to provide a profile, which is used to explore cases in their context. Then, in chapter five, case histories are summarised and comparisons are drawn between literal replications. Chapter six presents the main cross-case analysis between theoretical replications. Data are explored under a number of different headings. Objective data are cross-tabulated and the richness of responses is used to gain additional insights. Preliminary typologies are suggested, based upon identification of patterns of similarities and differences. In chapter seven, the five decisions to expand, or to withdraw from Ukraine, are studied.

In chapter eight, the findings from data analysis is set in the theoretical context. Finally, in chapter nine, the limitations of the thesis and future research directions are presented.

3.10 Summary of Methodology

This research is complex and inter-disciplinary in nature. There are possible inter-relationships between the decisions of a firm and those of its competitors (Johanson and Mattsson 1988) and arguments in favour studying decisions in context (Pettigrew 1985, Aharoni 1966). Consequently, an in-depth research methodology is believed to be most appropriate for this exploratory research study (Harrigan 1983, Bonoma 1985). A case study methodology is preferred decisions can be studied in their context.

The study comprises twenty decisions, by multinational corporations, to enter, expand or exit from the Ukraine. Originally, fifteen decisions were studied. However, during the period of data collection (July 1993 - March 1994), five additional decisions were made, to invest further, not to invest further or to retract. The study of more than one decision within the same firm corresponds to Yin's Multiple Embedded case study design (1983).

A semi-structured research instrument was designed, using propositions drawn from a comprehensive review of relevant literature in the fields of corporate strategy, marketing, organisational behaviour, economics and international business. 39 face-to-face interviews were held with respondents from both the western and Ukrainian operations of multinational corporations. The initial cases were drawn from three industry sectors; financial services, chemicals and household consumables. These sectors were selected because they were well-represented in Ukraine. More than one firm per sector was researched to allow literal as well as theoretical replications (Yin 1983). Preliminary analysis of data suggested that industry type was a more significant variable than industry sector. This proposition was tested by theoretical replications in other industrial, business-to-business services and consumer goods industries.

Respondents were allowed to give their own emphasis to the questions, giving detail on issues, which they felt were relevant to their decisions, and omitting or explaining the relative insignificance of other variables. Multiple sources of evidence were used. Press coverage, market research reports, company documents and on-line databases were used to verify information. Moreover, face-to-face interviews were held with key stakeholders within the Ukraine to gain additional information.

Three phases of data collection took place in Ukraine. These were in July and November 1993 and in March 1994. The comparability of case data was ensured by additional interviewing of original cases, as new cases were added. Additionally, the market environment in Ukraine was analysed, in order that case data could be understood in the light of the prevailing context. Decisions were felt to be influenced by the differences in the external conditions, which constituted their context.

Data were coded under the variables to which they referred. Under each heading, an appendix was also used, to record verbatim quotes and other relevant information which added richness to the study. Data were analysed over the period of data collection to identify emerging patterns of similarities and differences. From these patterns, explanatory variables for the decisions were identified. The findings from this process of data analysis were then set in their theoretical context, in order to draw conclusions relating to the original research propositions.

Chapter 4 - The Ukrainian Context

Research into turbulent markets faces a number of challenges. Perhaps the most significant of these is determining consistent criteria and sources of data to analyse changes in the Ukrainian environment. The previous chapter highlights the importance of understanding the context, in which data were collected, for understanding its content. If differences in the context are to be taken into account, in analysing data, then this thesis must address the question of how best to analyse the environmental conditions in Ukraine.

The task is complicated by four main issues. Firstly, Ukraine is undergoing a period of rapid and unpredictable change, as it moves towards a free market economy. Secondly, the duration of this period of transition and even the likelihood of a positive outcome is difficult to predict. Thirdly, the composition of the uncertainty is difficult to ascertain. It is comprised of a large number of variables, which are often inter-related and comprise both hard and soft issues. Finally, there are difficulties in determining a reliable contextual trend. The assumption that extrapolation of historical data will provide meaningful insights into the future is invalidated both by the unreliable historical data and the discontinuous nature of the changes.

This chapter begins by looking at the historical development of Ukraine and the changes wrought by the process of transition to free market economy. Subsequently, consideration is given to the way in which the country context can be analysed. A profile of the process of transition, from the beginning of 1991 to

March 1994, is created, which will be used in subsequent chapters as a backdrop for data analysis.

4.1 The Soviet Legacy

The COMECON (Commission for Mutual Economic Aid) Agreement was formed in 1949, but did not become active until 1959. From this time onwards, it laid out a series of five year plans decreeing which goods would be made, in what quantity, where in the Soviet Union. In order to achieve this, specialisation of production by country and by region, within the Soviet was encouraged (Times Guide to Eastern Europe). Thus, Ukraine has a significant proportion of the oil refining, chemical and nuclear power industries, whilst Hungary has a significant proportion of the motor industry production facilities for buses and vans. Monopolisation was encouraged. Some plants had up to 80% market share.

However, the centrally-planned system largely failed in terms of efficiency and living standards. Even prior to the demise of the Soviet Union, the Socialist system within the region was foundering (Åslund 1991, IMF/World Bank/OECD/EBRD report 1990). This has been attributed to exogenous shocks such as the loss of trade with the liberalised Central European countries in 1989, to the coal strikes of early 1991 and to the forced shutdown of plants for environmental reasons. However, research also highlights underlying endogenous factors. Shleifer and Vishny (1991) cite under-investment in new technologies, problems with the state-controlled pricing system and inefficient allocation of inputs. Frydman and

Rapaczynski (1991) add lack of technical and managerial skills, as well as the lack of a corporate governance system.

Shleifer and Vishny (1991) contend that the state-controlled pricing system distorted incentives and resulted in opportunistic behaviour. Inputs, fixed at rates lower than market price, were often diverted to the highest bidder, regardless of the consequences for downstream production. Repressed inflation had a number of negative consequences (Cotarelli and Blejer 1991), principally resulting in hoarding of intermediate outputs, which would hold their value better than money.

Since the beginning of liberalisation in the region in 1989, a number of opposing views have been put forward as to the most appropriate means of assisting East and Central Europe in its transformation to free market economy. There is a need for aid on the scale of the Marshall Plan, which helped Germany and Japan to regenerate after the second world war (Sachs 1991). However, as it is not regeneration, but building of an infrastructure from grass roots level, which is required, it is feared that funding alone be insufficient to counter the difficulties associated with adopting new technologies or developing entrepreneurial spirit (UN Report 1989 - 1990). Indeed, it has been argued that:

> "the outside world should give no financial aid, but should be generous in providing technical assistance and training." Åslund 1991.

One of the key tasks of the reform process is to create a "rational structure of corporate governance" where none had previously existed (Frydman and

Rapaczynski 1991. However, there is considerable debate as to the most appropriate institutional structures and models:

> "The task of privatisation is to construct (...) a corporate governance structure and institute it in an environment in which there is a pronounced lack of available personnel and a potentially unfavourable political structure" (Frydman and Rapaczynski 1991)

It is unclear whether a rational reconstruction of Western models in Eastern Europe is possible. Each model is the product of history and has evolved over time. Indeed, Frydman and Rapaczynski argue that the most advanced economies are still evolving and they have an irreductible element of contingency, idiosyncrasy and cultural specificity.

Given this uncertainty, it is not surprising that both the type of corporate governance structure and the process of introduction has varied between countries. Foreign investment, restitution of property to former owners and differing methods of privatisation have been preferred (Eastern European Privatisation News, September 1992). Whatever form it may take, the process of privatisation has been heralded as the number one priority (Stark 1990, Sachs 1991, Kornai 1992, Snelbecker 1993).

4.2 Transition to Market Economy

> "It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity, it was the season of Light, it was the season of Darkness, it was the spring of hope, it was the winter of despair, we had everything before us, we had nothing before us..." Dickens A Tale of Two Cities ,1868

In December 1991, in a popular referendum, the people of Ukraine voted to become an independent state. The period of Soviet central planning had officially ended. Amidst the general euphoria, the people of Ukraine looked forward to a prosperous future as a nation-state trading in the world market. Ukraine's refusal to sign Mikhail Gorbachev's Union Treaty had precipitated the collapse of the USSR and the formation of the new Commonwealth of Independent States (CIS). Ukraine had signalled its commitment to economic restructuring by being one of the first republics to press for its own currency. It was widely heralded as the former-Soviet Republic with the greatest potential (Deutsche Bank 1991, Europe 1991, Euromoney 1992.)

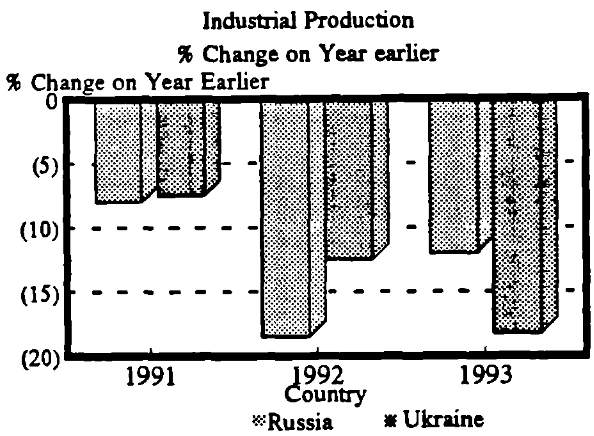
Yet, despite this initial optimism, the legacy of a repressive political system and the web of infrastructural and trade links between Ukraine and the former Soviet Republics has proved difficult to disentangle. The Economist survey of Ukraine (May 7th 1994) comments:

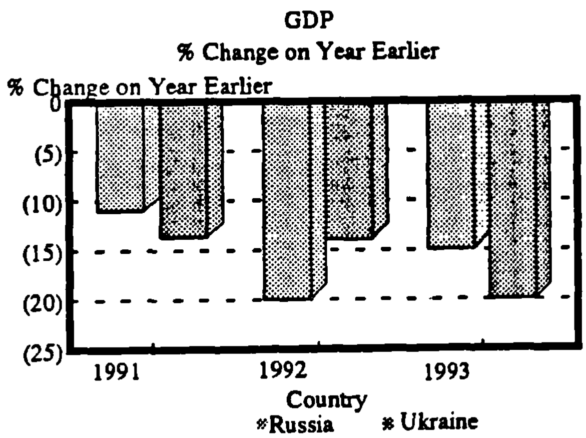
> "Ukraine floated to independence on a cloud of illusions (...) With 52 million people, it was bigger than all the rest [of the former Soviet States] bar Russia. It had stronger hopes of quickly establishing ties with the rest of Europe than, say Kazhakstan. And it had inherited a disproportionate amount of the former Soviet Union's industry (...) Thus one big illusion: that Ukraine is a wealthy place. two and a half years later, a majority of Ukrainians have still not come to terms with the fact that most of their Soviet-era dinosaurs are a liability, not a legacy."

If transformation to a free market economy does indeed take place, it will not happen in five years as initially predicted. More likely it will take fifteen to twenty years (Economist May 7th 1994).

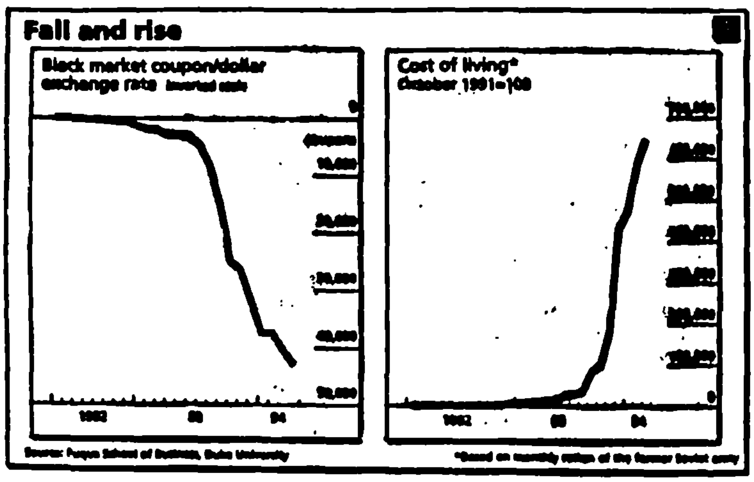
4.2.1 Economic Reform

On independence, Ukraine produced 34% of the Soviet Union's steel, 46% of its iron ore, 36% of its televisions and 53% of its sugar (Economist May 1994). However, the premature severance of ties with Russia has resulted in the loss of previous markets and a drastic decline in the economic situation. Figure 4.1 shows the 20% reduction in industrial output from 1990 to 1993. Moreover, the launch of the proposed new currency, the Griyivnya has been repeatedly postponed (Central European 1993), whilst the temporary currency, the Karbovanet, has failed to hold parity with the rouble. The financing of massive compensatory credits to striking miners fuelled inflation. The Economist quotes an inflation rate of 72% per month, an aggregate 5800% per annum (October 23rd 1993). The consequences of this inflation for the cost of living are shown in Figure 4.2.





Source: Economist Oct 23rd 1993



Ukraine also faces a potential energy crisis. The oil and natural gas, upon which it is dependent for both industrial and domestic purposes, come primarily from Russia. These are still priced at below world price. However, the cooling of relations between Ukraine and Russia raises doubts over the continuation of this agreement. Already, the quantities of fuel shipped have decreased as Russia can sell for a better price on the world market.

Comparison with other former COMECON neighbours suggests that they face similar, if less painful experiences. The current turbulent market conditions confronting many markets in transition may be an inevitable consequence of the destruction of turgid Soviet structures:

> "One of the several important differences between Ukraine today and Ukraine as it was six and twelve months ago is that Ukraine is now far deeper into the transition process than it was then. Old governmental command-control structures and institutional relationships have disintegrated to a far greater degree now than they had then, creating confusion and disorder (...) It may be tempting to conclude (...) that the best way for Ukraine to improve its business climate would be to return to the period of stability of last year. The conclusions would be a mistake (...) A more prudent policy would be to move forward swiftly and decisively, through the current transition period."
> (Manninen and Snelbecker 1993)

4.2.2 Political Stalemate

There is also political stalemate in Ukraine. On independence, the relatively apolitical Ukrainians opted for a gradual process of change, in electing as their President Leonid Kravchuk, a former Communist Party member skilled in negotiations with Russia. However, infighting between factions in the Ukrainian parliament has resulted in political stalemate. The resignation of the Ukrainian Prime Minister, Leonid Kuchma, on September 21st, 1993 was an indirect result of the blocking, by the communist majority, of the reforms necessary for privatisation and foreign investment (Wasylyk 1993).

One of the key problems of the Ukrainian political situation is the complex composition of parliament. In the elections of March 1994, candidates of sixteen different political parties were elected (Economist May 7th, 1994). Splitting of the vote was increased as the political parties of the candidates were not written on the ballot papers. However, the splintering of the nationalist movement into a number of different parties poses the most significant threat to reform. The six nationalist parties and the six parties of the centrist block, who wish to maintain some links with Russia, cannot reach sufficient agreement to counter the retrograde policies of the Communists. Economist (May 7th 1994) comments:

> "Four things are necessary to launch successful economic reform; a good plan, people capable of implementing it, some financial help and the political will to carry it through (...) The big question mark is over political will."

Whilst there was praise for the bloodless way in which Ukraine, in contrast to its Russian neighbours, has resolved its crises to date, Economist (October 23rd 1993) highlights the number of communist party nomenclature who retain their political positions. The latest proposals to halt the economic slide of Ukraine (the seventh such plan which has been attempted to date) suggest, alarmingly, that Ukraine is reverting to Soviet-style central control. Export bans, expropriation of profits from Western firms and state subsidising of essentials, such as fuel and food, seem to many to represent a step in the wrong direction (American Chamber of Commerce, Nov. 17th 1993). The election as prime Minister, in June 1994, of Vitaliy Masol, whose removal the Ukrainian students forced after a hunger strike in 1991, represents the most frightening sign that the process of transition has stalled. Indeed, it raises doubts as to whether Ukraine wishes to be independent of Russia (Economist May 7th 1994).

4.2.3 The Social Consequences of Reform

Despite the significant problems which Ukraine faces, there is little sign of public protest or discontent. Economist (May 7th 1994) describes the Ukrainian attitude as an "extreme form of Slav stoicism" which is rooted in the belief that nothing good comes from governments. Also, it highlights the lack of confidence in their identity. The Ukrainians, it claims, "tell jokes about themselves, not some other country". Additionally, Ukraine's periods of independence as a nation state have been fleeting, the most recent being a matter of months in 1917 - 1918. The Economist (May 1994) refers to its current state of independence as:

> "an extremely ambitious project in nation-building, a Yugoslavia in reverse"

The 1989 census of Ukraine reports that Ukraine is comprised of Ukrainians (73%), Russians (22%), Jewish (1%) and 4% from other Slavic groups. However, there is little evidence of tensions. This may be because the groups are intermingled with "no clear lines in the sand" (Snelbecker 1993), though the Ukrainians also tend to be apolitical.

The greatest threat to the stability of Ukraine comes from near neighbour Russia. In research commissioned by the US Information Agency (US Opinion Research 1992), Ukrainian citizens showed themselves willing to accede to Crimean independence. The majority of Ukrainians were also ready to dispose of their nuclear arsenal. Governmental reluctance to do so may result from a fear of losing their deterrent vis à vis Russia. Moreover, nuclear weapons represent a bargaining chip with which the Ukrainian government can gain funding from the West (Financial Times 19th November 1993.) The greatest fear of the Ukrainian people is that of aggression of a third-party, especially Russia.

Despite the political conservatism of the Ukrainians, worsening living conditions must be, at least, contributory to the tendency towards extremism seen at the recent elections. There is a polarity of views, between those in favour of radical reform and those, who would prefer to return to a Soviet-style régime.

4.3 Sources of Information

One of the key issues in analysing the Ukrainian context is the reliability of data. Information from official sources suffers from problems of timeliness, reliability and validation.

4.3.1 Timeliness

The rate of transition in Ukraine is such that information is often outdated before it can be published. Legal decrees change with such frequency that it has become current practice to publish these in the local newspapers. Western businesses, operating in Ukraine often had local staff and legal advisors monitoring the press to spot changes, which would affect them. The contradictory, and often draconian measures, which the government imposes, may have significant impact on western investors:

> "The General Manager of B1 has watched VAT levied on his products ping-pong from 0% to 20% and 28% and, for now, back to 0%. Legal flux is a given in Ukraine; recent retroactive changes in foreign investment laws (...) had 'investors screaming bloody rape'." Business Central Europe, February 1994.

4.3.2 Reliability

Official data were controlled under the Soviet system. Whilst they are, in many cases, the only data available, their reliability is doubtful. Variation between different sources is considerable. Even those sources, which should be reliable, such as banks and official government bodies produce incomplete, misleading or erroneous data. For example, Gross Domestic Product figures, produced by the Ukrainian National Bank in 1993, were not adjusted for inflation. Moreover, the inflation rates were not given anywhere on the report. Without these the data are useless.

4.3.3 Validation

The previously punitive culture in Ukraine has instilled an anxiety about revealing information, no matter how trivial. Consequently, sources are seldom revealed. Without these and the means of calculation, many data cannot be validated. Furthermore, there is an unwillingness to speak on the telephone, as the KGB used to monitor calls. It is suggested that the major hotels, frequented by westerners, are still monitored. Also culturally-specific is the unwillingness of Ukrainians to admit to weakness. Work with Ukrainian students on projects, with Ukrainian interpreters and colleagues has shown that the first response to a question "Do you know anything about...?" would invariably bring a claim of knowledge or expertise, which might later transpire not to be the case.

4.3.4 Sources of Information

Useful, local sources of data, although they often needed cross-validation, were:

> **Official Ministries** for specific industry sectors. These often provide statistics such as output figures and number and location of enterprises. In many cases, respondents felt that vital pieces of information were missing.
>
> **Former Soviet Union electronic databases** Two such databases have been identified. These are paid services and questions must be submitted centrally via a central administrator. The original source and method of calculation may not be revealed, therefore reducing the validity of the data.
>
> **Local Employees** are often connected into local networks. They are able to translate decrees in the press and might know how to get such market information, as exists.

Given the limited availability of data locally, multinational corporations have a high reliance on western sources of data. These include:

> **Western Press**, especially Financial Times and Wall Street Journal
>
> **Business Periodicals**, such as Economist, Business Central Europe, Central European Economic Review (Wall Street Journal Publication)
>
> **Embassies**. Lists of firms, who have investments in Ukraine, can be obtained from the relevant embassies. However, the currency and accuracy of such lists varies between embassies. Not all countries have a representation, therefore data are missing for some nationalities. Moreover, lists are compiled by the commercial attaché of the embassy. In some cases, the attaché does not have the most up-to-date information. The British Commercial Attaché explained that he was:
>
>> "to a large extent reliant on the firms to make themselves known to the embassy. Firms are more likely to do this, if they invest in the market, although there is no formal requirement to do so. Only those firms which have made contact are included. Also, there is no record of firms which export to Ukraine, but are not present in the market."
>
> **Privately-commissioned Reports**, such as the Dniepro-Petrovsk feasibility study. One respondent suggested that this type of information was useful if the data was verified by means of interviews with key respondents. Otherwise, it was, at most, useful as background:

"We originally used [published] reports on the market, but they were too general and out of date in a market which changes so rapidly." (E1)

"This type of data is useful for basic information, although it is very general, as it is not produced for a specific purpose." (B1)

The stakeholders in the Ukraine, most frequently cited in interviews, were:

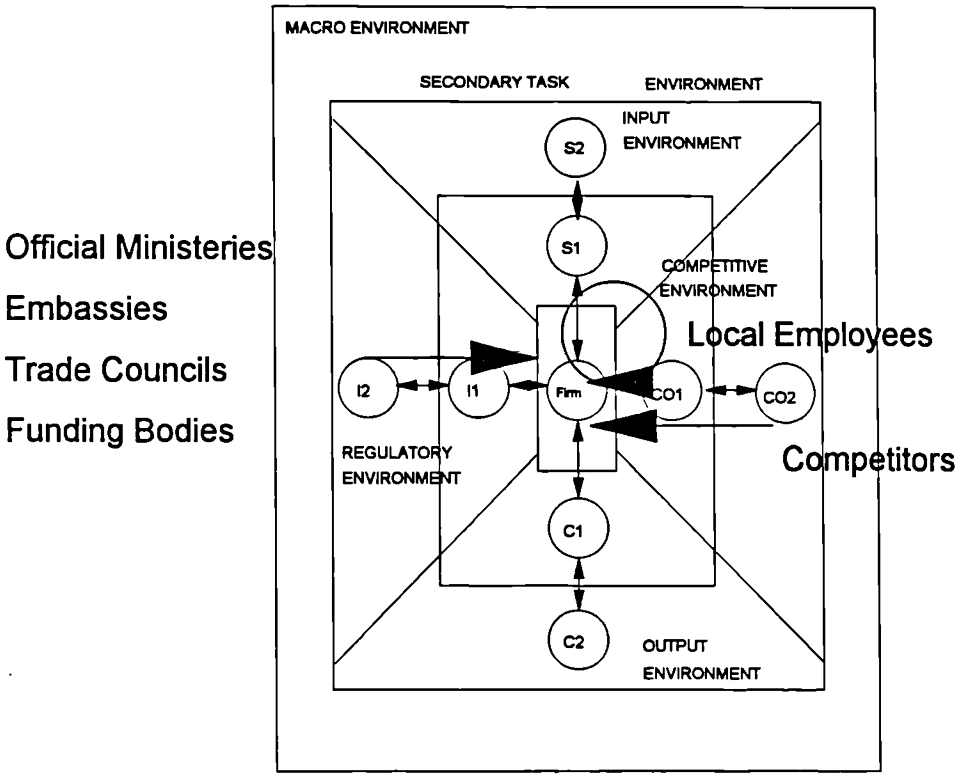
- **Competitors**
- **Embassies**
- **Trade Councils**
- **International Funding Bodies**, such as the EC, the World Bank
- **Business Service** Providers, such as accountants or lawyers
- **Western Market Research Agencies**
- **Consultancy Projects** by students of Ukrainian Business Schools
- **Consultancy** by Faculty of Ukrainian Business Schools

These are summarised on the Achrol, Reve and Stern (1983) framework in Figure 4.3.

There is a small, but growing, amount of western market research into Ukraine. Much of this results from Harvard University's Project for Economic Reform in Ukraine (PERU) or from the market information bulletins issued by the American Chamber of Commerce. Some insights into the Ukrainian market can be gained from these.

Manninen and Snelbecker's survey into criteria and barriers to foreign investment in Ukraine (1993) shows high profit potential (48%) and local demand (37%) as the primary motivations for investment, although the availability of cheap materials (30%) and low labour costs (23%) are also major attractions. However, contradictory and confusing legislation, lack of banking facilities and poor communications are seen as significant obstacles (See Figure 4.4).

Sources of Information in Ukraine



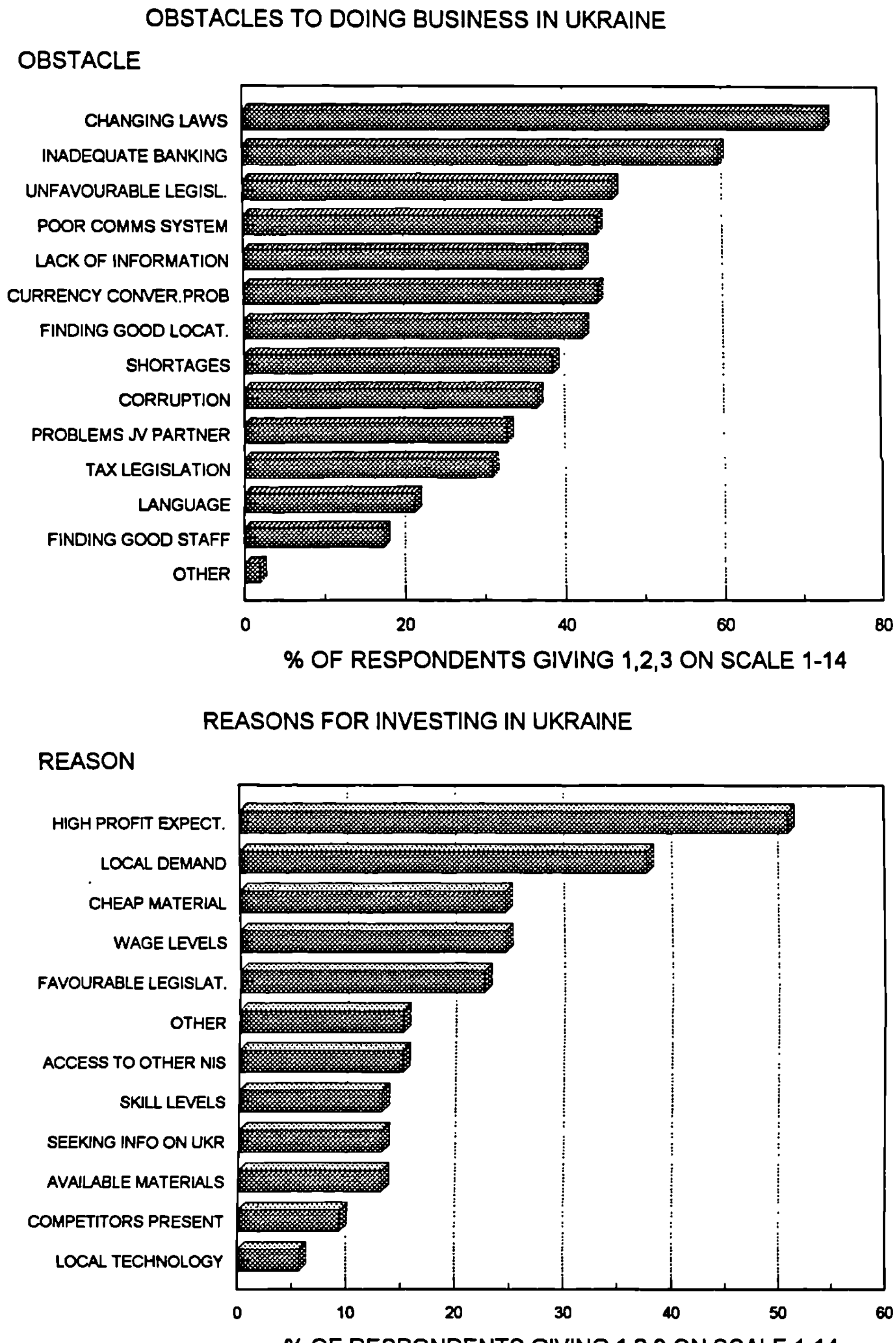
BASED ON FIG.1 "ENVIRONMENT OF MARKETING CHANNEL DYADS"

ACHROL, REVE AND STERN JOURNAL OF MARKETING 1983

I = INTEREST GROUP
C = CUSTOMER

CO = COMPETITOR
S = SUPPLIER

Figure 4.3



SOURCE: MANNINEN AND SNELBECKER APRIL 1993

Figure 4.4

Srinivasan (1994) makes the following assessment of the Ukraine as a market for potential investors (See Figure 4.5)

Strengths	Weaknesses
Size and Military Strength	Mind-set of Colonial Past
Strategic Location	Borders with 7 countries
Political Pluralism	Fragile Institutions
Population and Labour Force	Lack of Political and Administrative Experience
Science and Technology	Lack of Private Enterprise
Family and Social Infrastructure	
Physical and Natural Resources	
Industry and Industrial Infrastructure	
Opportunities	**Threats**
Rapid Economic Progress	Rise of the Extreme Right Parties in Russia
Central Role in European Affairs	Ethnic Divisions
Harmonising East and West	Macro-economic Instability

Figure 4.5 Source: Srinivasan 1994

The current period of discontinuous change in Ukraine makes it difficult to extrapolate any clear picture of investment potential. Looking at the economic indicators alone gives a bleak picture of the attractiveness of the market for potential investors (See Figures. 4.1 and 4.2). Research suggests that investment interest in Ukraine has declined. The findings of Deloitte, Touche Tohmatsu (12th Financial Times, October 1992) show that the attractiveness of Ukraine to potential investors is higher only than that of Romania (Figure 4.6).

	Hungary	Poland	CSFR	Russia	Ukraine	Romania
Austria	74	61	74	52	39	39
Denmark	52	76	48	36	6	6
France	48	40	52	36	36	20
Germany	65	65	71	65	41	35
Japan	40	10	10	20	0	10
Nor/Swe/Fin	33	55	33	78	28	11
UK	53	47	53	35	23	29
USA/Can	53	53	53	63	33	21

Figure 4.6 Financial Times 12th October 1992

This view is supported by research by the Wall Street Journal (July 9th 1993) at a Berlin Business Symposium. Ukraine, Kazhakstan and Russia lag behind other East and Central European countries. High perceived risks were the principle cause of this pessimism (See Figure 4.7)

Question: "In 20 years time, which East and Central European Country do you think will have the healthiest economy?"

Czech Republic	32%
Former East Germany	22%
Hungary	11%
Poland	9%
Russia	7%
Kazhakstan	1%
Slovenia	1%
Ukraine	1%

Figure 4.7 Source: Wall Street Journal, July 9th 1993

The decline in the attractiveness of Ukraine to investors, relative to Russia, challenges its value as a "gateway to the East," which Srinivasan (1994) and Manninen and Snelbecker (1993) report as a major strength. The Wall Street Journal (November 11th 1993) reinforces this view, concluding:

> "Ukraine's prospects, once bright, grow dim as its economy falters, a slow pace of reform causes inflation and scarcity of fuel."

4.4 Analysing the Ukrainian Context

Problems in finding reliable data and in extrapolating historical data, given the dramatic changes in the Ukrainian environment, raise the question of how best the context can be analysed. Use of objective economic data shows a market in crisis. However, use of economic data, alone, does not reflect the positive atmosphere which has arisen, at times, from favourable turns in legislation and political events, from the peaceful resolution of problems and the extreme good nature of the

Ukrainian people. Useful market research, as in the preceding section, offers snapshots of the market from 1992 onwards. However, there is no one regularly updated source, from the period predating liberalisation to date. Therefore, the analysis of the context for the investment decisions in this thesis needed to address two main problems.

Firstly, the analysis must incorporate hard and soft variables, therefore, economic data alone were felt to be insufficient. Secondly, it required a constant stream or stream of data for comparability, available for the period from entry of firms into Ukraine to the completion of data collection. The issue of consistency, which required identification of a trend, which could be compared between time periods and against which data could be analysed, was felt to be the most important issue.

The most reliable source of data, for this purpose, appeared to be western press coverage of Ukraine. Whilst subject to the bias of Western opinions, this offers a stream of data, which can be analysed over time. Thus, a content analysis of press coverage from January 1991 to March 1994 was carried out. More than one journal was used, to reduce the bias, resulting from individual styles and differences between US and UK vernacular.

The search terms for this content analysis were obtained after an initial frequency count of possible positive and negative descriptors. Full details of word occurrence are given in Appendix 1. The content analysis was based on CD-ROM versions of the Wall Street Journal, Financial Times, the Economist and on Reuters On-line system. At the first frequency count, it was apparent that Reuters was inappropriate for this purpose. It had no occurrences of any of the possible words. This may be because original press coverage from other sources is reproduced as summaries. Therefore, Reuters was omitted.

The words, which the frequency count shows as the most used positive and negative descriptors of the Ukraine, are given in Figure 4.8

Positive	Total Score	Negative	Total Score
Prospect	202	Risk	217
Opportunity	177	Threat	340
Investment	477	Crisis	343

Figure 4.8

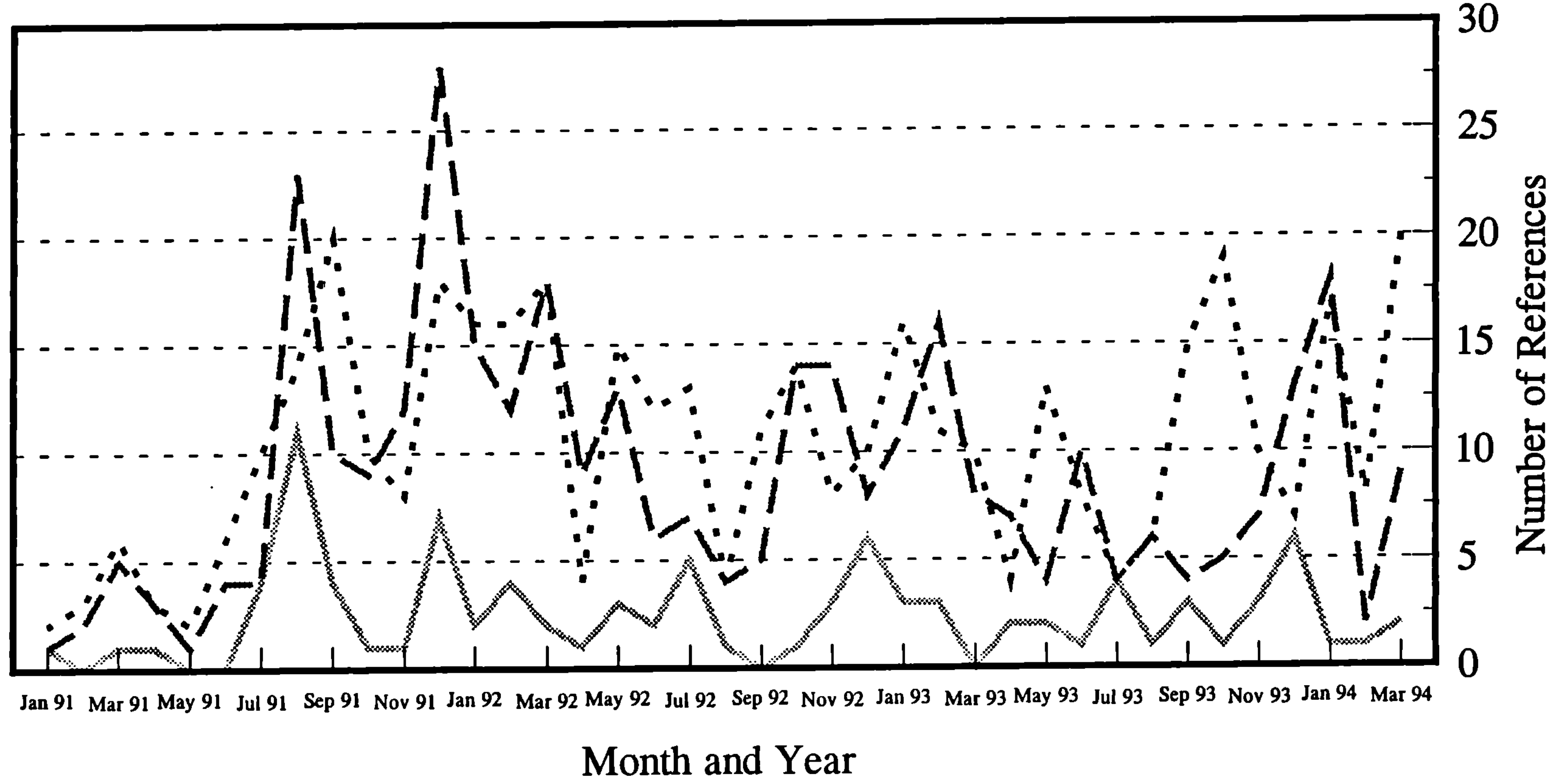
Each of the words was searched in conjunction with "Ukraine" to establish the number of times in which the two appeared in the same article. Each article was counted only once, even if there were multiple uses of the word. Monthly totals were taken for each publication. This overcame the difficulties represented by different frequency of publication.

Although the actual levels of word usage varied between journals (See Appendix 1) the trend was relatively similar between the journals (See Figures 4.9 and 4.10). The slight differences in timing may relate to whether the publication has a permanent correspondent (Wall Street Journal) in Ukraine, or uses syndicated coverage (Economist and Financial Times).

Positive Press Coverage of Ukraine

Economist, Wall Street Journal and FT

January 1991 - March 1994



Economist Wall Street Journal Financial Times

Figure 4.9

Negative Press Coverage of Ukraine

Economist, Wall Street Journal and FT

January 1991 - March 1994

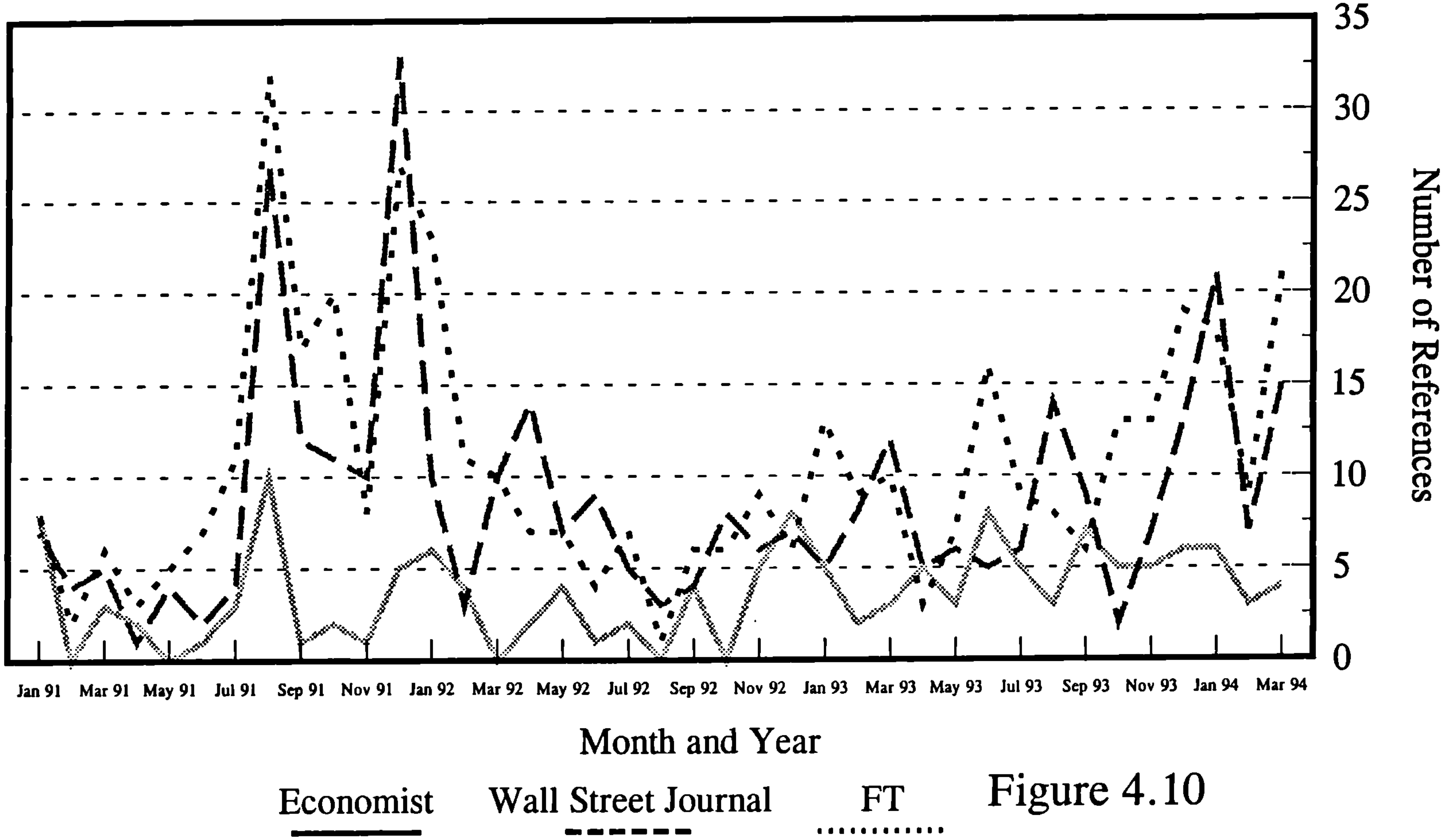


Figure 4.10

Data from the Economist is affected by the year end summaries and special features. To minimise the impacts of differences, total figures were calculated. From these an indication can be gained of whether the Western press coverage was predominantly positive or predominantly negative (See Figure 4.11). The resultant trends have the advantage of reflecting changes in all factors in the environment. They also show the stage at which perceptions of the market shifted from predominantly positive to predominantly negative. These trends will be built upon in subsequent chapters to give fuller insights into the prevailing climate when data were collected and when firms made the decision to enter the Ukraine.

4.5 Chapter Summary

Whilst objective data from press and the growing body of market research into Ukraine provides useful insights into the market, there is no one reliable source which tracks indicators over the period from 1991 to March 1994. Moreover, use of economic and political indicators would omit soft factors, such as the stoicism and good nature of the Ukrainian people.

The most appropriate source of data, for use in creating analysing the trend of positive and negative changes in the Ukrainian environment, was found to be Western press. It is acknowledged that this data may be subject to bias. However, press coverage on CD-ROM versions of three journals, the Financial Times, the Economist and the Wall Street Journal was analysed. From this, a trend of positive and negative press coverage was developed, which is used in the analysis chapters of this research. This provides insights into the prevailing context of the data.

Trend Analysis of Positive and Negative
Press Coverage of Ukraine
January 1991 - March 1994

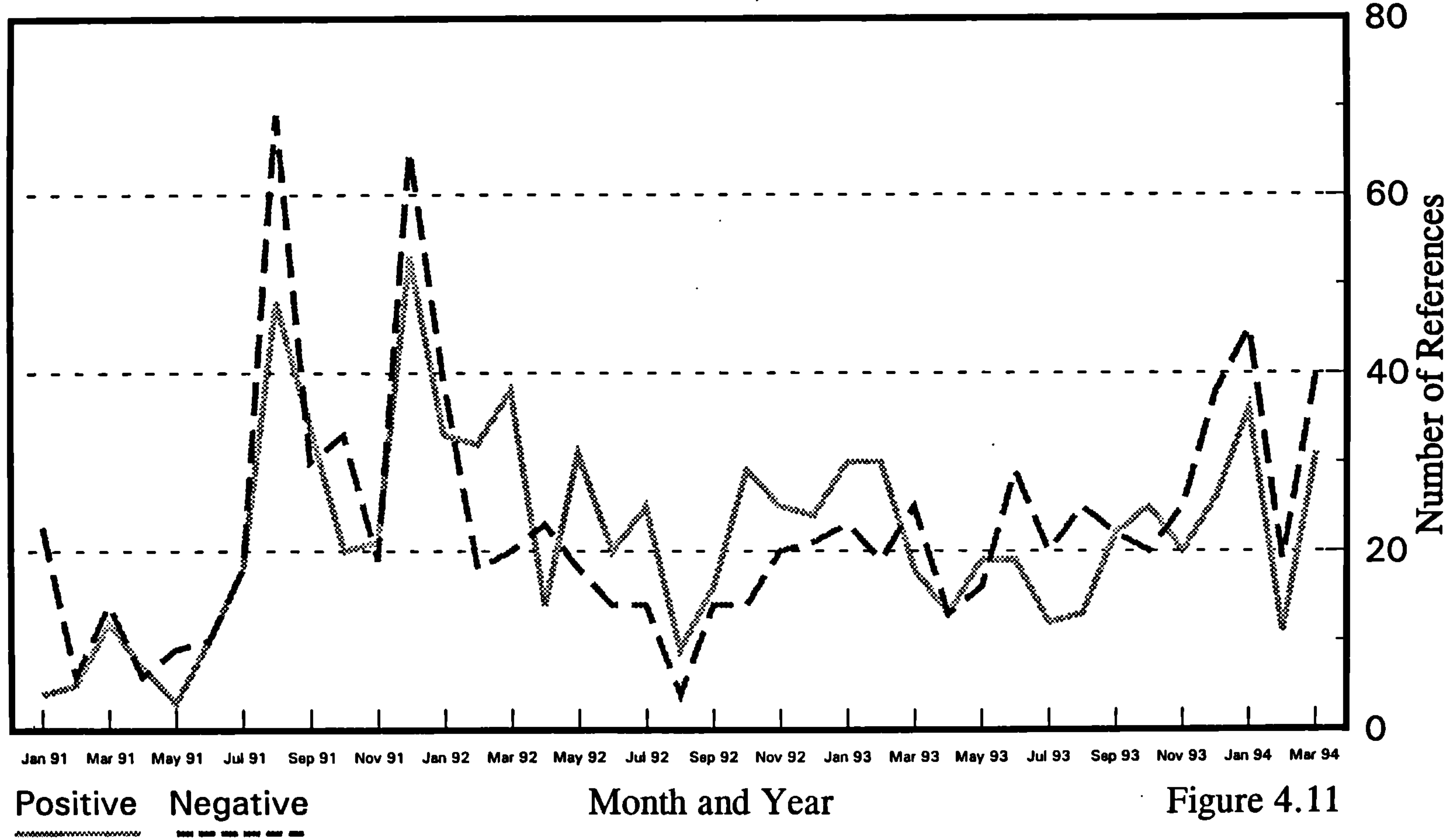


Figure 4.11

Chapter 5 - Case Histories in their Industry-level Context

5.1 Introduction

This chapter moves from consideration of the host country context to industry level. The external market conditions in Ukraine are similar for all firms. However, the modes of entry, which they adopt, and their experiences in the market vary. Therefore, variables other than country context must play a role.

Data are presented for financial services, law, tobacco, drinks, household products, chemicals, computing and telecommunications sectors. In this research, three cases are studied in the chemical industry, five from financial services, and two from household products. One case is drawn from each of law, drinks, tobacco, computing and telecommunications. Preliminary analysis shows similar dynamics in financial services and law sectors. Accordingly, these cases are analysed together under the business-to-business services heading. Similarly, tobacco and drinks are grouped together as high-margin consumer goods, whilst computing and telecommunications are classified as high-technology industrial products.

Secondary data are explored to gain an understanding of competitor activity in each industry. The patterns of investment activity in Eastern and Central Europe are compared within each industry sector. A synopsis of each of the cases is presented. Data for each industry type are summarised.

In analysing the patterns of investment in each industry sector, data on date, type and size of investments have been gathered from CD-ROM searches of the Wall Street Journal and Financial Times. Investment activity in Eastern and Central Europe has been researched from 1989 to date. The extent of the information obtained is dependent on how much the firm reveals in its press statement. The following provisos pertain:

5.1.1 Date of Investment

Press coverage of an investment may span more than a year. Press coverage of one joint venture in the chemical industry, from earliest talks to signing of an agreement, spanned the period from late 1991 to mid 1993. The St Petersburg joint venture of a firm in the mass-market consumer goods sector was first mentioned in late 1989. The final agreement was not signed until 1991. Accordingly, data on dates of investment are only approximate.

5.1.2 Size of Investment

Press coverage may disclose both the size of the initial investment and any investment in modernisation agreed in the contract. Although, this information is not available for every investment, indications can be gained of the approximate size of investment required to set up a manufacturing plant, or subsidiary in the different sectors.

5.1.3 Demographic Data

Demographic data relating to firm size and degree of internationalisation are drawn from both internal company documents and from secondary sources. For the sake of comparability, all data relate to 1991, the most recent year for which a full set of data are available. Sources are Hoover's Handbook of World Business and Handbook of American Business (1993) and Stopford's Directory of Multinationals (1992).

5.2 Industry A - Business-to-Business Services - *Financial Services and Law*

5.2.1 Competitor Analysis

The late 1980's have seen a number of mega-mergers among the global players in the accounting and financial services sector. By late 1989, the global industry had shaken out to a "Big 6" firms: Coopers and Lybrand, Arthur Andersen, Price Waterhouse, Ernst and Young, KPMG and Deloitte, Ross Tohmatsu. Using the demographic variables described in the methodology, the "Big 6" firms can be compared by degree of internationalisation and by size as in Figure 5.1.

Firm	Size		Degree of Internationalisation		
	Sales $ m	*Number of Employees*	*Number of countries with investments*	*Percentage of Sales ex home country*	*Length of international Experience*
A1	4,975	17,000	121	70%	70 years
A2	5,406	20,000	100	58%	50 years
A3	4,948	59,797	67	50%	47 years
A4	3,603	12,630	110	64%	93 years
A7	6,011	75,000	100	62%	84 years
A8	4,500	16,500	100	57%	105 years

Figure 5.1 Source: Hoover's Handbook of World Business 1993.
Hoover's Handbook of American Business 1993
Data are for 1991

Whilst some variation in size and degree of internationalisation is apparent, the Big Six firms can all be described as large, global players with a significant length of international experience. Internationalisation began prior to the second world war. In the post-war period, international growth has accelerated to the present global scale of competition.

5.2.2 Investment in Eastern and Central Europe

There was some investment activity in Eastern and Central Europe prior to liberalisation. This centred mainly on Hungary. A2 had been present from 1987 onwards. A4 entered Hungary in 1988. However, the majority of activity in the region began in 1989. Initial investment activity focused on Central, rather than Eastern Europe. The pattern of entry into the region is shown in tabular form in Figure 5.2. In all but one case, firms entered Hungary first. Firm A3 entered Poland and Moscow in 1989.

Investment in the former Soviet Union tended to take place later, as liberalisation did not take place until 1991. The progression eastwards can be seen more clearly when shown on the map of Eastern Europe (See Figure 5.3). The countries, which are circled, are those in which four or more of the Big Six firms had invested. Comparison is drawn between investment in the region in 1989, 1990 and 1992. By late 1992, all of the Big Six were represented in Hungary, Poland, the Czech and Slovak Republics and in Moscow, Russia. The interest of financial services firms may relate to entry into the region by international customers:

> "Tempted by Kazhakstan's wealth of natural resources, accounting practice Price Waterhouse has opened an office in the capital Alma-ata. The practice was started to meet the growing demand for advisory services from western multinationals, especially in the oil and gas sectors." Central European, March 1st, 1993.

> "It was not until one of their biggest customers (...) sought advice for [its] new subsidiary, that Deloitte and Touche quickly established offices in Budapest, Prague, Warsaw and Moscow." Tozsde Kurir March 26th 1992

However, it is also strongly motivated by the availability of contracts funded by agencies such as the European Community, or the European Bank for Reconstruction and Development. Press announcements of such contracts show their frequency and size:

"Ernst and Young have been selected to prepare the registration system for the Small Investor Share Purchase Programme while Coopers and Lybrand have been selected as the advisor for the public share placement (...) The Know-How Fund continues to finance J. Henry Schroder Wagg and Co. Ltd, which prepared the programme and the legal advisors, Baker and McKenzie. The Know-How Fund for Hungary began in April 1990 with a total allocation of £25 million over five years." MTI-Econews June 14th 1993.

"Romania's five private ownership funds (POFs) are appointing advisers to help them adapt into western style mutual funds. In one of the first such appointments, a team of advisers from consultants Price Waterhouse and the UK law firm Sinclair Roche and Temperley travelled to Romania in early June for the first leg of a 12-month contract to provide legal and financial advice." Central European June 1st 1993.

"The Hungarian State Property Agency (SPA), with the support of USAID, is on the verge of offering a $6 million contract to accountant Deloitte and Touche to provide deal-making expertise to the SPA." Central European, June 1st. 1993.

Data on financial investment in Eastern Europe by these firms are difficult to ascertain. However, numbers of staff are available for some investments. A3 entered Poland with 3 people. A2 entered Poland with 8, and A8 with 2.

In the intervening period, as they have developed specialist knowledge of the transition to free market economy, the financial services and law sectors have prospered. A3 expanded from 3 people in Poland on entry, to 65 people by the following year. A2 expanded its operation in Hungary to 130 people by 1990 and again to 170 by 1992. Similarly A8 reports a growth from 22 staff in 1989 to 120 staff in 1990. In late 1990, many of the firms added an office in Bratislava, Slovakia to the original investment in Prague.

Investments in the CIS, especially Ukraine, Kazhakstan and expansion from Moscow into St Petersburg begin in 1991.

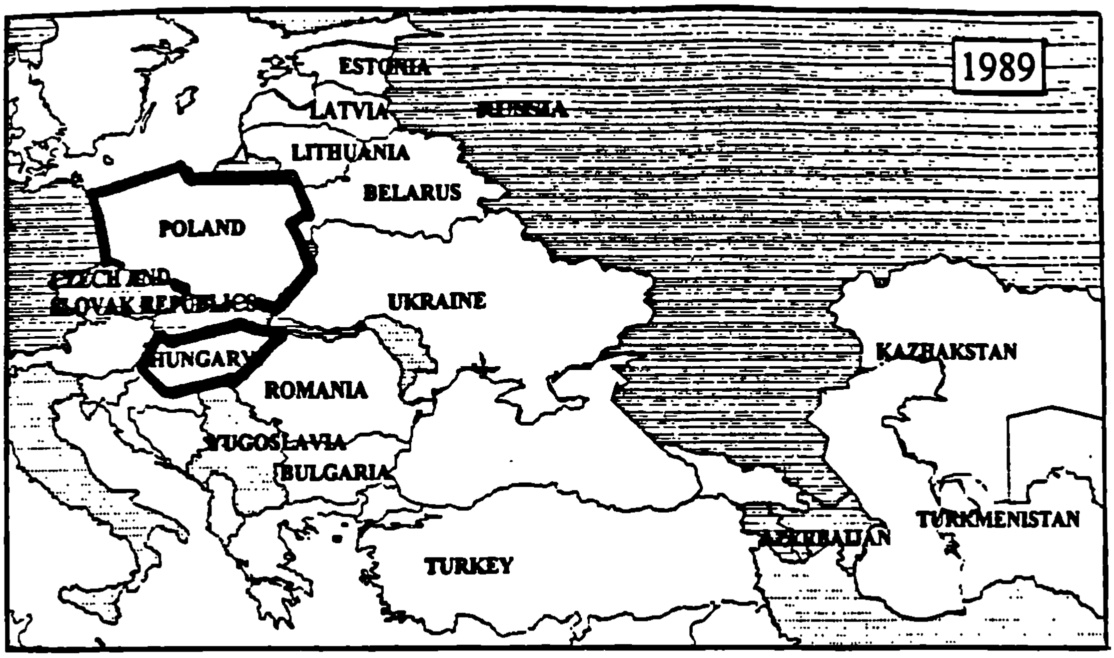
"Price Waterhouse was amongst the first accountancy firms to set up in Eastern Europe (Budapest, Berlin, Moscow, Prague and Warsaw) and its Budapest office now has 200 staff, up from 22 in 1989, 120 in 1990 and 170 in 1991." Figyelo, October 22nd 1992.

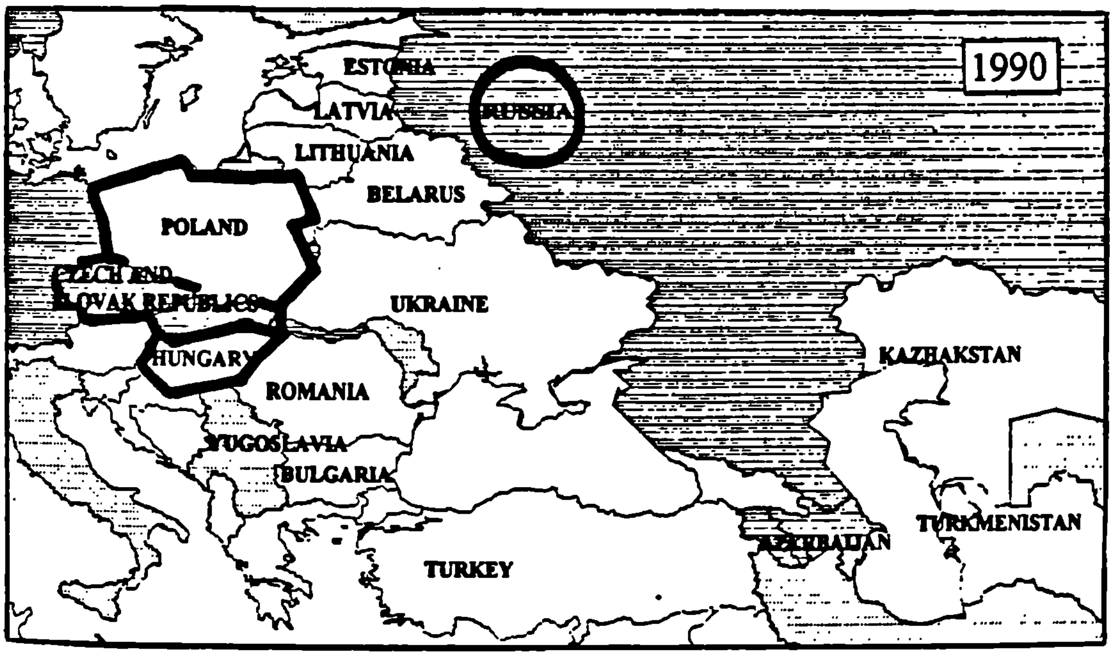
"1991, the first full year of business, was profitable, though a loss would not have been surprising" Toszde Kurir, March 26th 1992.

"DLT is pleased with the state of its investment in Hungary (...) It now has 70 clients in Hungary, as well as its long-standing foreign clients (...) DLT is now in a position where it is showing an operating profit, although it will be some time before the initial investment is repaid." Figyelo, May 27th 1993.

	1989	1990	1991	1992	1993	1994
A1	Hungary	Czech R (early-mid 1990)	Slovenia Russia	Ukraine Bulgaria		
A2	Hungary	Russia Moscow Poland (October) Czech R	Ukraine (late 1991)	Kazhakstan Russia (St Petersburg)		
A3	Poland Russia (Moscow)	Czech R Slovak Republic Hungary (late 1990)	Ukraine (late 1991) Latvia (Riga) Russia (St Petersburg)	Bulgaria Kazhakstan		
A4	Hungary	Czech Republic (May) Slovak Republic Poland		Bulgaria	Kazhakstan	Ukraine
A7		Hungary	Czech R Poland Russia	Estonia		Ukraine
A8	Hungary (July)	Poland Czech R Slovak Republic	Russia		Ukraine	

Figure 5.2


1989
ESTONIA
LATVIA
RUSSIA
LITHUANIA
BELARUS
POLAND
CZECH AND
SLOVAK REPUBLICS
UKRAINE
HUNGARY
ROMANIA
KAZHAKSTAN
YUGOSLAVIA
BULGARIA
TURKMENISTAN
AZERBAIJAN
TURKEY


1990
ESTONIA
LATVIA
RUSSIA
LITHUANIA
BELARUS
POLAND
CZECH AND
SLOVAK REPUBLICS
UKRAINE
HUNGARY
ROMANIA
KAZHAKSTAN
YUGOSLAVIA
BULGARIA
TURKMENISTAN
AZERBAIJAN
TURKEY

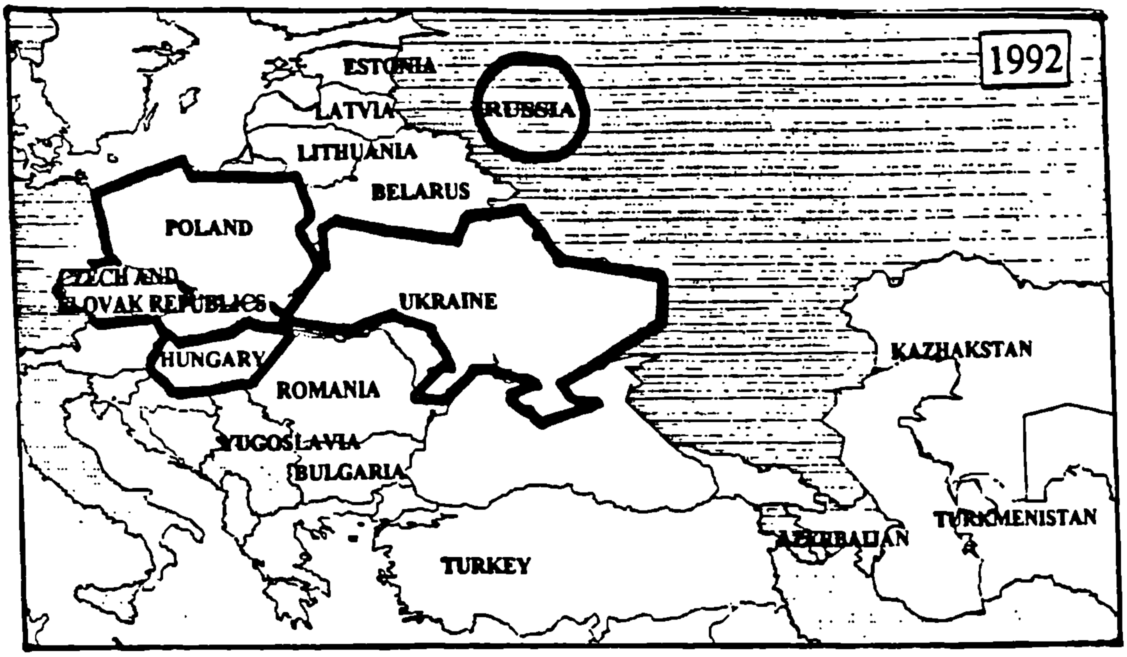


Figure 5.3

> "Andersen Consulting has become the first Western Company to launch a systematic recruiting campaign in Czech universities. At the moments Andersens has a staff of 100 specialists in the Czech Republic." Rude Pravo, April 29th 1993

Four of the Big Six financial services firms had invested in Ukraine, by the time of data collection (May 1993 - March 1994). The other two entered later in 1994. Comparison between the size of the investment in other Eastern European countries and in Ukraine shows these to be roughly comparable. A1 entered Ukraine with 1 person, as did A2.

5.2.3 Business-to-Business Service Cases

Case A1

In the USA, A1 was not involved in the merger activity of the late 1980's. However, in 1989, the UK subsidiary joined forces with another of the Big Eight accounting firms. As a result of standing alone, A1 went from being the largest of the Big Eight players, to the third largest of the Big Six. It is fifth largest player in the USA. In 1991, sales were $4,975 million and there were 17,000 employees. The ownership structure of the firm is that of a partnership. The firm is Anglo-American, having been formed by the transatlantic merger, in 1957, of a large US and a large UK accounting firm.

Firm A1 is highly internationalised. The first international investment activity began 70 years ago. The US part of the firm was established in 1898, and expanded into Europe with offices in Berlin (1924), Paris (1926) and London (1929). The Berlin office was closed in 1938, as the outbreak of the Second World War became inevitable. The UK part of the firm was founded in 1854. International expansion began with the opening of offices in Brussels (1921), New York (1926) and Paris (1930). By 1991, 70% of the firms sales came from its international operations. It had 100 offices in the USA and investments in 121 different countries.

After liberalisation, the firm's interest in Eastern Europe began with an investment in Hungary. This was followed rapidly by expansion, in 1990, into the Czech and Slovak Republics and in 1991 into both Slovenia and Russia. Investment in Ukraine, via both a European Expertise Service joint venture and a wholly-owned subsidiary followed in June 1992. The firm entered the Bulgarian market in the same year.

Interest in the region was stimulated by the availability of funding from the EC and the World Bank. Existing links with these bodies, via the Brussels and Washington subsidiaries of the firm, gave it a good basis to become their advisor, especially on issues of privatisation. The decision to enter Ukraine was prompted by the firm's Commonwealth of Independent States (CIS) Practice group. The US, UK and German members of this group influenced the decision to invest in the market. However, the final decision was strongly linked with the firms involvement in the EC's Technical Assistance to the CIS (TACIS) programme.

Primary considerations, when making the decision to enter Ukraine, relate both to market potential and to logistics; was there sufficient business to make the subsidiary viable as a profit centre and how would it operate? The firm's joint venture partner provides Eastern European expertise. They have close links with the Ministry of Economics. However, the regulatory links of A1 are such, that they see themselves as key providers, rather than users, of market information. They feed information on market developments both to embassies and to international clients.

Despite the worsening market conditions, during the period of data collection, firm A1 thrived. They gained a large, externally-funded contract and increased the number of expatriate staff permanently based in the market. By March 1994, there were two expatriate representative members of the firm and eight Ukrainian staff in the subsidiary.

Case A2

Firm A2 are also one of the Big Six accounting firms. After the merger of two of the big eight firms in 1987, this firm now ranks as the second largest both in the USA and in the world. In 1991, it had sales of $5,406 million and 20, 000 employees. As in the previous case, the firm has a partnership structure. One of the merged firms was the result of a post-war alliance between a British and an American firm. The other part was American. Therefore, the firm's nationality is Anglo-American, but it has partners world-wide. By 1991, A2 had investments in 100 countries world-wide and fifty eight percent of its sales were outside the USA. The firm has been involved internationally since the late 1940's.

A2 was earlier into Eastern Europe, than many of its competitors. It set up an office in Hungary in 1987. The success of this venture, and the subsequent liberalisation of the market, resulted in rapid expansion, during 1990, into the Czech and Slovak Republics, into Poland and into Moscow. Investment in Ukraine took place in late 1991. The firm set up a joint venture with two Ukrainian sleeping partners.

As the Moscow office had been established 18 months before the Ukrainian subsidiary, it played a significant role in the decision to enter Ukraine. The original decision to enter was made in London. However, the market was prospected from

Moscow. The decision to enter the Ukraine was made after the successful entry of a major international client, Tambrands. There are links between the two firms in a number of markets around the world. The Kiev Office was opened during a Public Relations event involving British firms investing in Ukraine. This was called "British Days in Kiev". During this, the Kiev office of A2 was opened by Margaret Thatcher.

The Ukrainian and other Eastern European subsidiaries are viewed by the UK office as representing a relatively low level of risk. They require only a small financial investment. Most of the assets are portable and could be withdrawn from the market if necessary. The major issues, in operation in Ukraine, are those of gaining reliable information and uncertainty, as to the rate at which international firms will enter the market. Whilst business is sought with Ukrainian firms, it is recognised that, in the short-term at least, the firm is heavily reliant on international firms and contracts from the regulatory sector.

The investment in Ukraine was guaranteed by the British subsidiary of A2 for one year. However, during this time, the operation expanded such that it was too large to be supported by the British subsidiary alone. Further investment was made by A2 internationally. The subsidiary is accountable, in the first line, to the CIS Practice Group. There are many links between the main office of the practice group, in Moscow, and the Kiev Office. The manager of the Ukrainian subsidiary previously worked for the firm in Moscow. Indeed, staff are brought into Kiev from Moscow, if skills are not available locally.

There are currently fifteen employees. Three of these are British, American and Irish expatriates. The remaining 12 are Ukrainian nationals. The mix of nationalities is seen as positive, it improves the firm's ability to deal with international customers. However, the British manager suggested that it would be "years before a Ukrainian ran the subsidiary." This relates to the type of industry. Guaranteeing consistent service quality, between markets, is of primary importance.

There is competition between the large firms in the industry, but also a certain amount of community spirit. The manager of A2's Ukrainian subsidiary maintained that some information is shared between firms. Also, the firm would not wish to expand by poaching international clients from other firms. In the UK subsidiary, more emphasis was placed on expansion by gaining regulatory contracts, than on international customers. The process of bidding and winning these contracts was seen as a contest between the major firms and smaller competitors, of different nationalities. One week Spanish co-ordinating firms might be favoured, the next Greek or French. The EC felt that it must achieve a balance between the different nationalities. Also, it could not award all contracts to the Big Six firms.

Despite the worsening climate, A2 also went from strength to strength during the period of data collection. Their expansion was not based upon the entry into Ukraine of more international clients, but rather upon gaining a large regulatory sector contract.

Case A3

The third case in this sector is also one of the Big Six accounting firms. The fourth largest of the six world-wide, A3 is the largest player in the US market with sales of $4,948 million and 59,797 employees. It was not involved in the merger activity of the late 1980's. The firm was founded in 1913 in the USA. It expanded rapidly within the domestic market. However, it did not become involved in international expansion until the period between 1947 and 1963. During this time, it opened eighteen more offices in the USA and expanded, first into Mexico, and then into 25 other countries. In 1991, A3 had three hundred and seven offices in sixty seven countries. Fifty percent of its sales were international.

A3 differs from its competitors, in that it began its Eastern European investments in Poland, rather than Hungary. Late in 1989, it was also the first entrant into Moscow. This was prior to the break-up of the Soviet Union. It was followed into Russia, in 1990, by firm A2, and by the remaining four of the Big Six in 1991. In 1990, A2 expanded into the Czech and Slovak Republics and into Hungary.

Entry into Ukraine came in late 1991. Indeed, three of the Big Six, A1, A2 and A3 claimed to be the first entrant into Kiev. In fact, all of the firms set up their operations at a similar stage. The market was prospected, for A3, by three staff from the Moscow Office, which had grown, in the interim period, to be a sizeable subsidiary with 120 staff. The decision to enter was taken because of clients setting up operations in Ukraine. The Kiev office was set up to provide service coverage. 80% of A3's clients are foreign investors in the market, whilst 20% are Ukrainian.

The firm operates, in Ukraine, through a wholly-owned subsidiary. There are currently sixteen employees. Five of these are expatriates. The managing partner is Canadian, the Head of Audit and Business Services American, the Audit Managers are British and Australian and the Head of Tax is Dutch. There are eleven Ukrainian employees. Five work in tax and six in audit. The firm is the first to have begun graduate recruitment in Ukraine. Good young students are sought from new business schools, which are setting up in Kiev.

Younger Ukrainians were seen to have greater potential, as they are less governed by the rule-based culture and may be more willing to change. However cultural problems have been encountered en route. There is a need for approval of actions, even if this involves insignificant decisions. Ukrainian staff also have different expectations as regard timescale. They might expect negotiations on a Joint Venture to last for six months rather than the average of one month, with no greater return. Moreover, there are cultural differences in etiquette. If there are problems, Ukrainian staff may scream and yell, which is not well regarded by international clients.

Any decision to expand in the market would be taken by the partners "globally." This would be based on the level of international business, which is available. The success of the firm is seen to be strongly dependent on having "good connections." A major part of the firm's business involves facilitating meetings between western investors and possible Ukrainian joint venture partners. However, difficulties are experienced because of the growing levels of corruption in the market. Once, import and export deals might require a bottle of vodka to a corrupt official. Now requests for $10,000, to be deposited in a Swiss bank account, were reported by a number of A3's clients.

Market information is important for A3's operation in the market and plays a significant role in the quality of the service, which it provides to its customers. This information is gained from foreign press publications and from translation, by Ukrainian staff, of the legal decrees in the press. The firm gains much of its information via word of mouth and from its international connections. The value of the statistical data, available from secondary sources is limited. It requires verification through interviews and is hampered by non-reporting and by the speed of change.

The only real contact with other firms in the sector is via the American Chamber of Commerce. The Chamber organises both informative and social events, at which expatriate staff may encounter each other. The manager of A3 saw financial services as a global industry with strong rivalry between the large players. A3 was aware of the actions of its competitors. Approximate dates of entry, numbers of employees and mode of operation could be provided for the Eastern European markets. Five of the Big Six were operating in Ukraine. One firm, A7 was bringing in staff from other proximate countries. A8 had only two or three staff. The remaining two were larger. A3 saw itself as the first entrant and largest player. This view was contradicted by A1.

Case A4

At the time of data collection, A4 was the only one of the Big Six firms not operating in the Ukraine. A4 is the smallest of the Big Six firms, largely because it was not involved in any of the mega-mergers. The firm was originally British. It was founded in London in 1860, although it now has partners around the world. International expansion began when a permanent representation was set up in New York and Chicago in the 1890's. By the 1930's, the firm had 57 offices and 2,500 employees globally. In 1991, A4 had sales of $3,603 million and 12,630 employees world-wide. There are investments in 110 countries and 64% of sales were outside of the USA.

Firm A4 is active in Eastern Europe. It was an early entrant into the region. After merging with a Swiss firm, in 1989 A4 entered Hungary. This was followed in 1990 by rapid expansion into Moscow, into the Czech and Slovak Republics and into Poland. The firm also has investments in Bulgaria and Kazhakstan, which it entered in 1992. The Eastern European investments appear to be prospering. The Budapest office now has 250 staff, Moscow has over 100 people, and there are 140 staff in the Prague office.

The manager of the Eastern European Services division, in London, suggested that any decision to enter Ukraine would be dependent upon the level of business available. The organisation is "territorialised," therefore a decision to enter Ukraine would most likely be made in Berlin, the nearest large office. At the end of data collection, members of the US subsidiary were operating in Ukraine on a project basis. The firm still has not fully entered Ukraine.

Case A5

Firm A5 is a smaller player in the accounting sector. It has only 1300 employees, compared to the smallest of the Big Six, A4, which has 12,630 employees.
It has a strong domestic base in France and partners in 25 countries world-wide. The firm operates in 5 Eastern European markets: Czechoslovakia, Hungary, Poland, Russia and Ukraine. It also operates in the eastern provinces of reunified Germany.

A5 entered Ukraine in 1992, when it gained an EC TACIS contract. However, it did not go into Kiev, where the larger players were setting up, but into Dniepro-Petrovsk. One respondent suggested that this was because the large players would bid for every contract in the capital city. However, in 1993, there was seen to be sufficient business for A5 to set up an office in Kiev. This decision was primarily influenced by the winning of a major EC contract, which required the provision of logistical support for visiting faculty. The Kiev subsidiary has only one permanent expatriate and one Ukrainian employee. During data collection, another large contract was gained, with another recipient organisation in Kiev.

Case A6

A6 is a law firm. However, it has similarities to the previous cases, as it is also concerned with providing reliable information to its international customers.

There are a number of foreign-owned law firms now operating in Ukraine. Many of these are small. One of the highest profile firms, Alex Frishberg and partners, began when the eponymous partner had his suggestion of entry into Ukraine refused by the large US law firm, which then employed him. He left and founded his own organisation in Ukraine.

Firm A6, are one of the larger law firms in Ukraine. Nonetheless, with 100 employees in seven major markets, they are both smaller and less internationalised than the other business-to-business service firms studied. The firm was founded in 1978 in Paris. Prior to this, partners of the firm had gained significant experience of former Soviet Union, where they had operated since the 1960's.

There are two major foci of the firm's business activities. One of these is European, and particularly French, legal matters. A6 has subsidiaries in London, and New York. The second, and fastest growing area, is that of trade, investment and finance in Central and Eastern Europe. The firm now has subsidiaries in Moscow, Warsaw, St Petersburg and Kiev. Additionally, there are co-operative agreements with legal counsel in the Czech and Slovak Republics, Kazhakstan, Bulgaria, the Baltic States, Romania and Belarus. There are thirty five lawyers in the CIS practice group,

Thus, whilst the firm is smaller than some of the others studied, it has an extensive representation in Eastern and Central Europe. The firm began its operations in the region because of the actions of its international customers. Entry into Ukraine was largely influenced by assisting Tambrands, one of its largest international customers, in setting up its pioneering 1988 joint venture agreement in Ukraine.

The Kiev office was opened in 1992, after the associate who runs the office returned from spending time working with lawyers in the London office. By 1993, the firm's Moscow office, with 30 full-time staff was one of the largest of any international law firm. In July of that year, the firm expanded into St Petersburg, where it now has three permanent staff. The Warsaw office has expanded to six staff. In Ukraine, there are three permanent members of staff, one of whom is a US citizen of Ukrainian extraction and a representative at counsel.

5.2.4 Summary of Business-to-Business Services cases

a) Demographic Data

This research studies four of the Big Six accountancy firms. These firms are described henceforth as A1 - A4. Two other business-to-business service firms were studied. These were considerably less internationally-diversified and substantially smaller than the Big Six. A5 is also a financial services firm. It has 1300 employees, compared with the 12,630 employees of the smallest Big 6 firm (A4). It operates in 25 countries, compared with the next smallest of 67 (A3).

One law firm (A6) was added to the study, as a theoretical replication. As the data for this firm were similar to those of the financial services firms, they have been grouped together under the heading of business-to-business services. A6 operates in 7 countries, so is still multinational. However, with only 100 employees, it is considerably smaller than the other cases.

Sector	Firm	Size		Degree of internationalisation	
		Sales $ mill.	*No. of Employees*	*Percentage of Sales Overseas*	*Number of Countries invested*
Financial Services	A1	4,975	17,000	70	121
	A2	5,406	20,000	58	100
	A3	4,948	59,797	50	67
	A4	3,603	12,630	64	110
	A5	*	1300	*	25
Law	A6	*	100	*	7

Figure 5.4 * Data unavailable

All of the business-to-business firms were partnerships. Firms A1 to A4, all large global players, have partners in offices world-wide, though not necessarily in every country in which they have an invested. The smaller firms, A5 and A6, tend to have partners centred in the country of origin. Within its East and Central European Practice group, firm A6 has fifteen partners, two of associate status, mainly located in London and Paris. There are now four Eastern European partners. A5 has many of its partners in France. Given the split ownership structure, it is difficult to determine the nationality of the firms.

b) Entry into Ukraine

Respondents gave, as a criteria for their interest in Ukraine, the wish to explore the market's potential. However, it is not clear that this, alone, would have provided sufficient motivation to enter. Many of the firms operate in a number of East and Central European countries. Therefore, they are relatively experienced operators in markets in transition.

Firm	Criteria for Entry	Date of Entry	Type of Operation	Number of Employees	Criteria for Expansion
A1	External Funds	Late 1991	Joint Venture	9	More Ukrainian or International Clients
A2	Client-serving	Late 1991	Joint Venture	15	Larger Client Base/ External Funding
A3	Client-serving/ External Funds	Late 1991	Wholly-owned Subsidiary	16	More International Clients
A4	No Entry		-	-	Entry of International Clients-
A5	Market Niche/ External Funding	1992	Wholly-owned Subsidiary	2	External Funding/ More International Clients
A6	Market Niche	1992	Wholly-owned Subsidiary	3	More international Clients

Figure 5.5

In many instances, the business-to-business firms obtained funding from external bodies, such as governments and aid agencies. They were also co-ordinators and advisors to these external bodies, with whom they work on a number of contracts within the region. Furthermore, the actions of international customers provided a strong impetus to enter Ukraine. Firms were concerned to provide consistent service quality to international customers. If an major international customer entered an Eastern European market, this was viewed as a good reason to enter.

5.3 Industry B - High-margin Consumer Goods - *Tobacco and Drinks*

5.3.1 Competitor Analysis

The tobacco industry has three dominant global players, R J Reynolds Nabisco, Philip Morris and BAT, and a number of smaller competitors such as Rothmans of the UK, Reetsma of Germany and Seita of France. Key drivers in this industry are availability of tobacco and low labour costs for manufacturing.

Firm	Size		Degree of Internationalisation		
	Sales $ m	*Number of Employees*	*Number of countries with investments*	*Percentage of Sales ex home country*	*Length of international Experience*
B1	1,581	22,190	17	74%	23 years
B3	14,989	56,000	19	18%	50 years
B4	48,064	166,000	10	33%	93 years
B5	10,823	110,823	55	58%	90 years

Figure 5.6 Source: Hoover's Handbook of World Business 1993
Hoover's Handbook of American Business, 1993
Stopford, J M Directory of Multinationals 1992.

The size and degree of internationalisation of firms in the tobacco industry is shown in Figure 5.6. The size of the largest international competitors, is considerably greater, both in terms of employees and sales than the financial services firms. Those firms with manufacturing operations tend to have significantly larger numbers of employees than the service cases. A significant proportion of these may be in the production function. The degree of internationalisation also differs from the previous sector. Firms are comparable in the percentage of their business, which is overseas. However, they have fewer and larger investments.

5.3.2 Investment in Eastern and Central Europe

The pattern of investment activity in the tobacco industry is shown in Figures 5.7 and 5.8.. Three of the firms began their Eastern European operations in either Poland or Hungary. Firm B4 had long-standing links with Russia and focused on Russia, as well as Central Europe, when investing in the region. The progression from Central into Eastern Europe was largely governed by the date on which the industry was privatised in each country. However, firms also tend to use large, manufacturing investments as hubs, from which they serve the surrounding markets.

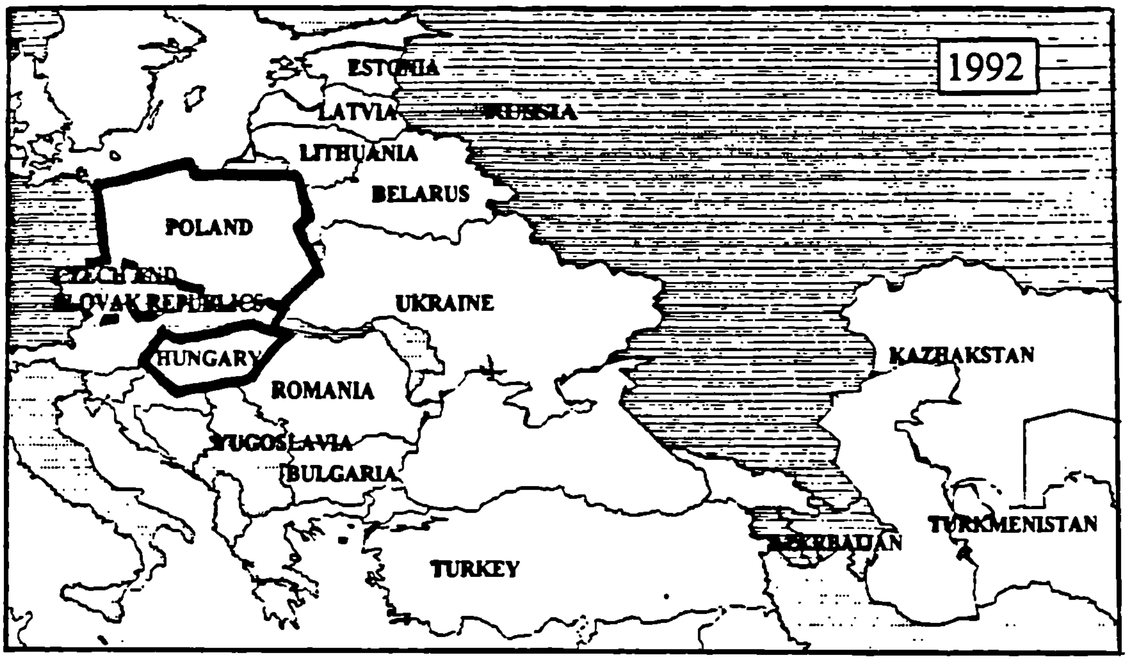
In Hungary, the three main production facilities were privatised in the course of 1991. By the end of 1991, two large plants, Pecs and Egri had gone to BAT and Philip Morris respectively, and a third, Debrecen went to R J Reynolds in January 1992. In the same year, a smaller Hungarian plant, Satoraljaujhely began producing cigarettes under licence for SEITA, the French producer of Gauloises and Gitanes. The share which each of these firms had of the Hungarian market in 1991 was BAT (46%), Philip Morris, SEITA and Austria Tabac (22%), R J Reynolds (32%). (Central European 01/02/92).

The privatisation of the Czech tobacco industry was announced somewhat later in September 1991. Competition was equally fierce and the process of selecting the preferred bid complex. A preliminary tender for the largest target, Tabak, the Czech manufacturing enterprise with five factories around the country, attracted bids from both Philip Morris and R J Reynolds (BBC Monitoring Service Eastern Europe 16/04/92). The Czech Government then announced a public competition, in which:

		1989	1990	1991	1992	1993	1994
B1	Export				Poland	Ukraine 04/93 Russia 04/93	
B3				Poland Hungary	Russia Ukraine		
B4	Russia Since mid 1970's Production under licence		Russia	Russia (Volga) Hungary 26/10/91	Russia (St Petersburg) Czech R Yugoslavia	Lithuania	
B5	Hungary involvement for over 20 years			Poland 01/01 Hungary		Ukraine 26/03/93 Russia	

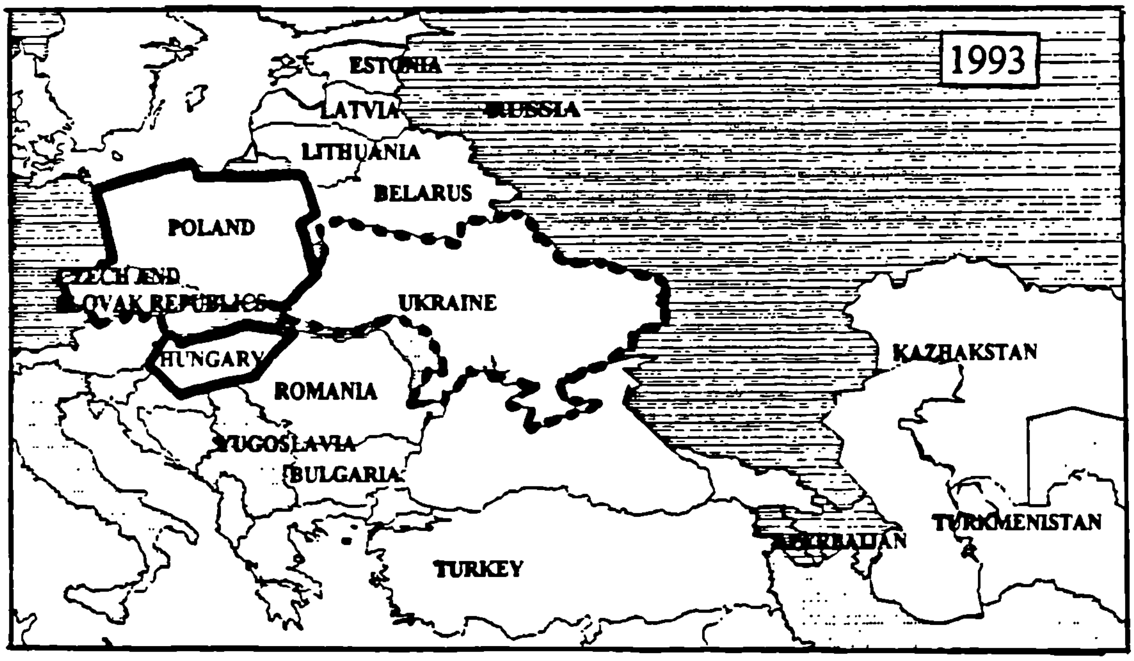
Figure 5.7

Figure 5.8



Three or more firms with high levels of investment

One to three firms with high levels of investment



> "any company which submitted a proposal by 20th January 1992 could take part. Competing plans were also submitted by BAT, Rothmans, the Seita company of France and Reetsma of Germany. The conditions for bidding for A.S Tabak included a commitment to maintain the enterprise as a single unit and a pledge not to lay off any workers of the company for the next five years. Nomura, an English consulting agency, is to evaluate the offers and the final decision will be made by a special commission of the Czech Ministry of Privatisation." (BBC Monitoring Service Eastern Europe 16/04/92).

The final decision, to sell the factory to Philip Morris for $104 million plus $140 million in modernisation over the next year, was fiercely contested by its oligopolistic rivals, as it gave Philip Morris monopolistic control over the Czech market. Reetsma subsequently reached a successful agreement with Slovak International Tabak (CTK Business News, 21/04/92).

The Polish market has three main producers, Cracow (33 billion cigarettes), Radom (30 billion) and Poznan(22 billion). These three plants accounted for 90% of total sales in Poland (Gazeta Bankowa 26/04/92). Smaller producers, in Lublin, Lodz and Augustow produce around 5 billion cigarettes per annum. Until mid 1992, four production licences had been granted by the agriculture ministry. The volume of imports was also controlled, by the Ministry of Foreign Economic Relations (Reczpospolita 15/07/92).

The control of access to this large potential market heightened western rivalry. On the announcement of the transformation, in May 1992, of Poznan, Augustow and Lublin into Joint Stock companies in May 1992 (Gazeta Bankowa 24/05/92) western firms were already establishing potential links. Philip Morris had produced under licence in Krakow since 1973 and were interested in investing in a controlling interest in the firm (Gazeta Bankowa 03/05/92). BAT were in negotiation with Augustow and Reetsma with Poznan.

Hence, it appears that in the tobacco industry, the dynamics of investment are influenced by a different set of factors, than those in the financial services markets. The date of entry and target country are not only influenced by the timing of privatisation, but the limited availability of investment targets, which leads oligopolistic rivals to "jockey" for the best positions as each market opens up. The rivalry was encapsulated by B1's description of having "lost out" to rivals in bids in Czechoslovakia and being determined not to do so in the markets of the former Soviet Union. It is also prevalent in press coverage, which speaks of Polish firms "flirting" with potential investors (Gazeta Bankowa 24/05/92) of "winners" in the tendering process, of the "Big Rush" when new privatisation targets are announced. Thus, Central European (01/08/93) stresses that:

> "the world's top cigarette companies are queuing up to acquire control of Almaty Tobacco Kombinat (ATK), the only cigarette producer in the central Asian republic of Kazhakstan, which is being sold in the country's first hard currency privatisation transaction. Kazhakstan is the ninth country in central and Eastern Europe to try to attract foreign investment into its tobacco industry. Western companies already control the cigarette industries of Hungary, the Czech Republic and Slovakia; foreign investments have also been made in Lithuania, Poland, Slovenia, Russia and Ukraine. The size of Kazkhakstan's cigarette market and ATK's monopoly status makes the company all the more attractive to potential investors (...) ATK will be privatised by competitive tender, with the winner to be picked by a 12-member tender committee that includes representatives from the company and the government." (Central European 01/08/93)

5.3.3 Cases of High-Margin Consumer Goods Firms

Case B1

This firm is one of the smaller players in the tobacco industry. With sales of $1,581 million, in 1991, and 22,190 employees, B1 is an order of magnitude smaller than the largest firm in the sector, which had sales of $48,064 and 166,000 employees in the same period. B1 is a producer of cigarettes and of luxury products, such as jewellery, watches, leather goods and perfumes. The firm was founded in the UK in 1890, making handmade cigarettes. However, it is now multinational in ownership. In 1986, B1 set up a Joint Venture in Canada, with the tobacco industry's largest player. It has a 60% stake in this operation. The holding company is now 60% Swiss-owned. The firm has 50 factories in 17 countries world-wide. International sales, represent 74% of the total.

B1 exported to Eastern Europe, prior to liberalisation, but everything was channelled centrally via Moscow. After liberalisation, the firm were interested in exploring the potential of the region. However, research required much more basic information, than would usually be required. The firm had to begin by looking at maps and gathering demographic data, in order to determine which markets were sufficiently large to be of interest. B1 saw Eastern Europe as being a "virgin" market, which together with China and Vietnam, was one of the last remaining areas for global competitors to contest. Initial interest in Eastern Europe was prompted by large, unsolicited orders from Poland. As this market, was one of those which appeared important, B1 set up a local office. It then began looking at the next tier of markets. In both the Czech Republic and in Hungary, B1 was outbid by larger rivals. Therefore, it moved its focus of attention to the Former Soviet Union.

B1 established a Joint Venture to set up a greenfield manufacturing site in St Petersburg. Whilst the market was seen to be unstable, gaining even a small market share would compensate for the risks, which B1 accepted were high. It was more concerned with assessing the size of the opportunity, to see if these risks were justified. The next choice of market in the Former Soviet Union (FSU) was between Ukraine, Kazhakstan and Uzbekistan. These were seen as possible first steps toward entry into the larger, but more turbulent Russian market. In the case of B1, the aim was to set up a local production facility, because products were too expensive, if imported. Lower commitment options, such as a representative office, were only contemplated as an interim solution, if it were felt that further market information was required before making this commitment.

B1 decided that there was a *prima facie* case for entry into the Ukraine. The market was large, and widely heralded as having better potential for reform than Russia or the Southern Republics. It had originally served Ukraine by exporting products manufactured in the UK. However, the production costs of these were higher than the selling price of locally produced products. The decision to invest in the market was made in December 1992. A member of staff came out from the UK to prospect the market in January 1993 and, in April 1993, B1 entered the market via a representative office. This was intended only as the first step. The subsidiary consisted of one expatriate member of staff, with a home office set up in a hotel bedroom.

Throughout the summer of 1993, B1 attempted to gather information on market size and possible joint venture partners. Two of the larger tobacco firms (B3 and B5) were in the process of signing manufacturing agreements. However, B1 felt that it needed to be more cautious, given its smaller size. The market information, which could be gathered from secondary sources was found to be contradictory.

Legislation surrounding investments was confusing. Moreover, the market conditions in Ukraine worsened considerable during this period. A primary research survey of the market revealed that, whilst consumers were keen to buy "status brands", they had low levels of disposable income. Therefore, they would only buy small quantities of the western brand when a visible "badge of capitalism" was required. They were likely to buy local products, for every day use.

In the late summer of 1993, B1 decided against setting up a manufacturing operation in Ukraine. The Southern Republics, and Russia itself, now appeared to have greater stability and potential than Ukraine.

Case B2

B2 is a firm in the drinks industry. It is a Canadian-owned Multinational, based in Quebec. However, its sales in this market represent only 3% of the total. 45% of sales come from the USA and the remaining 52% from other international markets. Founded in 1928, the firm operated, at an early stage, in the USA, as well as Canada. Following the acquisition of two small distilleries in the USA in 1933, B2 acquired a distillery in Scotland in 1935, and another in 1949. Investments in France in 1954 and 1960, Jamaica 1953, Italy 1960 and Germany in the 1960's were all guided by the availability of products with strong national reputations - rum in Jamaica, whisky in Scotland, champagne in France and wine in Italy.

After diversification into a number of other areas, during the 1960's and 1970's, the firm has grown to its 1991 size, with sales of $6,127 million and 17,700 employees world-wide. B2 has investments in 31 countries. The Eastern European division of B2 is situated in London.

In press coverage of the company's expansion into Eastern Europe, it is explained that investment began in the Central European countries which "are adapting fast to western commercial business methods." Subsidiaries were established in Hungary and Czechoslovakia in September of 1992. Whilst these markets were relatively small, they were seen as the first bridgehead in Eastern European expansion. B2 expanded into Poland in early 1993. Entry into Ukraine was the next step, in July 1993. This operation was described as "a wholly-owned marketing, sales and distribution operation in Ukraine" and took the form of a prestigious retail store in Kiev. In addition, B2 set up a manufacturing Joint Venture to capitalise upon local skills in vodka distilling.

Investment in Ukraine was seen as another step towards eventual investment in the Russian market. At the end of 1993, a subsidiary had been established in Moscow. As yet, no large investment has been made in the market. The attraction of the move eastwards was seen by B2 to be that of market size. Thus, the firm began with market sizes of 10 million in Czechoslovakia and Hungary, progressed to 30 million people in Poland and 52 million in Ukraine. It's aim is the Russian market, which has a population of 150 million. However, there is a trade-off between size and stability, the markets have become progressively less stable, as the firm has progressed eastwards.

B2 believes that the potential of Eastern Europe will not be fully recognised until the next millennium. As market conditions worsened, B2 was considering its future. In March 1994, an announcement as to whether the firm would continue with its retail store, or retract to a sales and marketing subsidiary was expected imminently.

5.3.4 Summary Data for High-margin Consumer Goods

a) Demographic Data

The firms studied in this research include one case from each of the tobacco and drinks industries. Both firms are large multinational players. One firm is British and the other Canadian. However, the Canadian firm has 45% of it's sales in the United States, whilst the British Firm is 68% owned by a Swiss Multinational.

Sector	Firm	Size		Degree of internationalisation	
		Sales $ mill.	*No. of Employees*	*Percentage of Sales Overseas*	*Number of Countries invested*
Tobacco/Drinks	B1	1,581	22,190	74	17
	B2	6, 127	17,700	53	31

Figure 5.9

b) Entry into Ukraine

In addition to the risks of investment, western firms in the tobacco industry must consider themselves "winners" even to strike a deal with their potential partner. The stakes involved in investment in the tobacco industry are much higher than those in financial services. The size of investment in the tobacco industry is considerably larger. Investment in manufacturing facilities in Eastern Europe has a mean value of $46.5 million. The mean additional investment, in modernisation of production facilities, is $74.2 million. The range and mean of investments are summarised in Figure 5.10 below.

Sector	Financial Implications of Investment *Range*	*Mean*
High-margin Consumer Goods *Tobacco/Drinks*	$5 million - $104 million	$46.5 million initial plus $74.2 million modernisation. Total $120.7 million

Figure 5.10

The drinks industry has characteristics similar to the tobacco industry. The large available market in Ukraine is the major criteria for entry. There is a similar concern over the premium price of products. Whilst it is clear that western products are seen to be 'badges' of high status, it is not clear what percentage of the population can afford to buy them.

> "Imports are seen as high status: expensive, but high quality. They are 'badges of capitalism.' Local branded products are selling for less than our cost of production. We would have to produce in the market to compete with other western brands. Otherwise, we may not even gain a share of the percentage of that market, which can afford to buy status brands." (B1)

Western brands may be an occasional rather than a frequent purchase. Distribution is via similar channels. Currently western brands of cigarettes and alcohol are sold in dollar shops and privately owned kiosks. There is still some distribution through the state-owned retail system. Consequently, cases from these two industry sectors are grouped together under the heading of high-margin consumer goods.

Firm	Criteria for Entry	Date of Entry	Type of Operation	Number of Employees	Criteria for Expansion
B1	Market Potential	April 1993	Representative Office	1	Improvement in Ukrainian Economy
B2	Market Potential	Dec. 1992	Retail Store and Joint Venture	10	Success of Current Ventures

Figure 5.11

5.4 Mass-market Consumer goods - *Household Products*

5.4.1 Competitor Analysis

The nature of the rivalry and investment structure in the household products sector is similar to that of the tobacco industry. There are two household products and personal care giants, Unilever and Procter and Gamble. In each of these product areas, they compete with a different subset of firms. Colgate Palmolive and Johnson and Johnson are the largest rivals in personal care. Johnson Wax and Henkel are significant players in the household products market. Key drivers in this industry are market potential and low labour costs for manufacturing. The size and degree of internationalisation of the firms is shown in Figure 5.12.

Firm	Size		Degree of Internationalisation			
	Sales $ m	*Number of Employees*	*Number of countries with investments*	*Total number invest.*	*% of Sales ex home country*	*Length of international Experience*
C1	3,400	13,400	47	73	75%	50 years
C2	27,026	94,000	47	62	45%	80 years
C3	40,767	298,000	69	214	38%	94 years
C4	24,900	24,800	40	232	64%	65 years
C5	9,172	41,475	55	97	69%	81 years

Figure 5.12

Source: Hoover's Handbook of World Business 1993; Hoover's Handbook of American Business, 1993. Stopford Directory of Multinationals. Data are for 1991

5.4.2 Investment in East and Central Europe

Initial investment via a sales and marketing subsidiary might covers all sectors of the firm. However, subsequent investments might be made for each Strategic Business Unit (SBU).

Hence, firms in this sector might make multiple investments in a country in the same time period. The pattern of investment by country is summarised in Figure

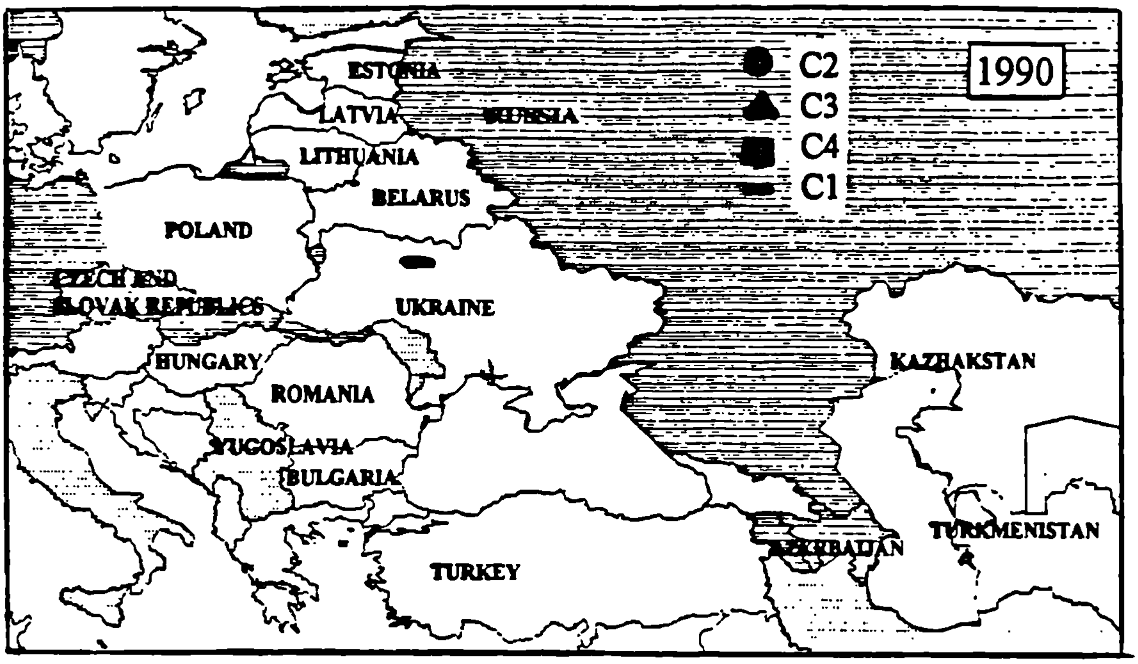
5.13. This is shown on the map of Eastern Europe in Figure 5.14. Whilst there was little investment in the region, prior to liberalisation, the number of investments increased rapidly from 1989 to 1991. The trend is similar to that seen in the tobacco industry. Date of entry was governed by the date on which production facilities in East and Central Europe were privatised. Initial investment interest was centred upon Hungary, Czechoslovakia and Poland, where a similar bidding process was employed.

A number of the firms had already had long-standing trade with the region prior to liberalisation. C3 had owned a manufacturing subsidiary in Hungary, but was forced to withdraw from the market in 1948. Re-entry into the market commenced with production under licence in 1971 and a new subsidiary was set up, which began manufacturing in the market, again, in 1992 (Heti Vilaggazdasag 12/06/93). Other firms had exported to the Soviet Union via the centrally-controlled channel in Moscow. However, C1 was a true pioneer. It began negotiations for its manufacturing Joint Venture in the Soviet Union in 1988, prior to liberalisation of the region. Larger rivals did not enter the market until at least a year after liberalisation of Central Europe.

In household and personal care products, firms began the process of entry into the region an average two years later than firms in financial services. A contributory factor for this relative tardiness may be the size of investment required. Interest in the region was reported in the press from 1989 onwards. The process of identifying targets, bidding and negotiating investment deals may have taken the intervening period of time.

	1989	1990	1991	1992	1993
C1		Ukraine			
C2	First reported Negotiations in Russia		Poland (Distributor)	Russia (Detergents)	Greenfield (Nappies) Poland
			JV Russia (Moscow) September	Ukraine Sales and Marketing Subsidiary	
			JVs Hungary Paper/Personal		
			100% Acquisition (manufacturing) Czech republic		
C3	Licensed production of margarine 1971		Production under license (dairy) Czech Republic		JV Dairy Czech Republic
			Poland JV detergents Manufacturing 1981	Russia Sales and Marketing (Moscow)	Hungary Acquisition ice-cream 100%
	Licensed manufacture teas Hungary			JV M'turing (detergent) Hungary	Poland JV 70% Margarine manufacture
			Hungary JV Distributor Ice cream	JV Vegetable Oil Hungary	
			Hungary Sales and Marketing Subsidiary	Hungary JV 80% Manufacture detergents 3 factories	
				JV Ice-cream Hungary	
C4	Export		JV Poland Manufacturing	JV early 1992 Manufacturing Personal care/ Household	
	Reported Interest in Hungary		JV Romania Manufacturing		
			Sales and Marketing Hungary		

Figure 5.13


1990
C2
C3
C4
C1
ESTONIA
LATVIA
RUSSIA
LITHUANIA
BELARUS
POLAND
CZECH AND
SLOVAK REPUBLICS
UKRAINE
HUNGARY
ROMANIA
KAZHAKSTAN
YUGOSLAVIA
BULGARIA
TURKMENISTAN
AZERBAIJAN
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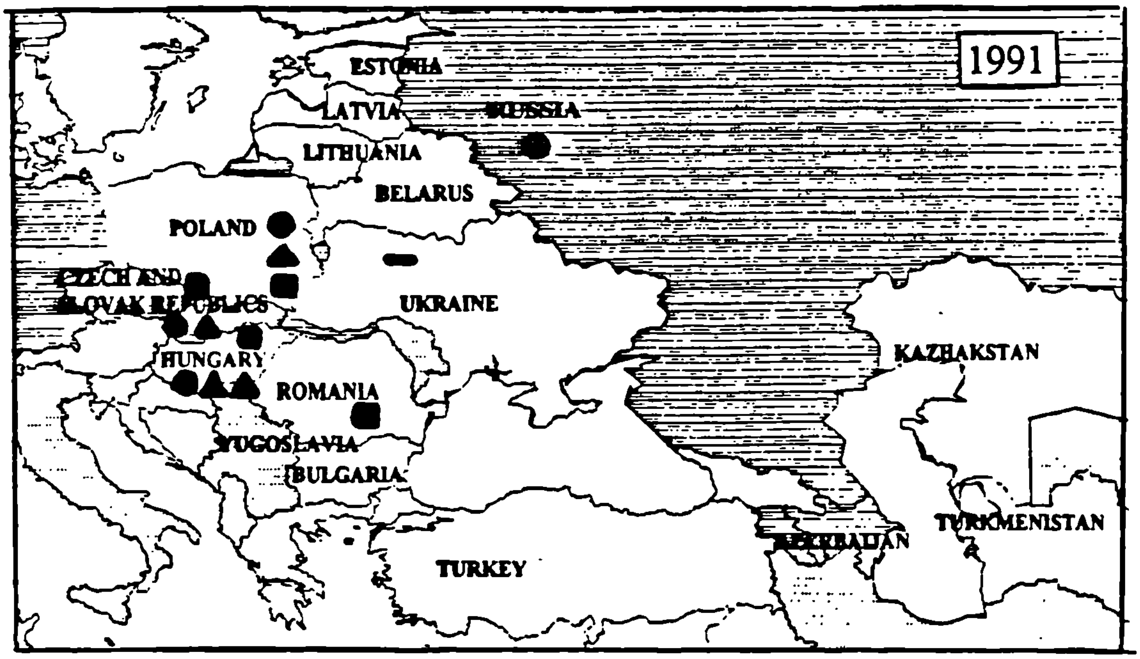
1991
ESTONIA
LATVIA
RUSSIA
LITHUANIA
BELARUS
POLAND
CZECH AND
SLOVAK REPUBLICS
UKRAINE
HUNGARY
ROMANIA
KAZHAKSTAN
YUGOSLAVIA
BULGARIA
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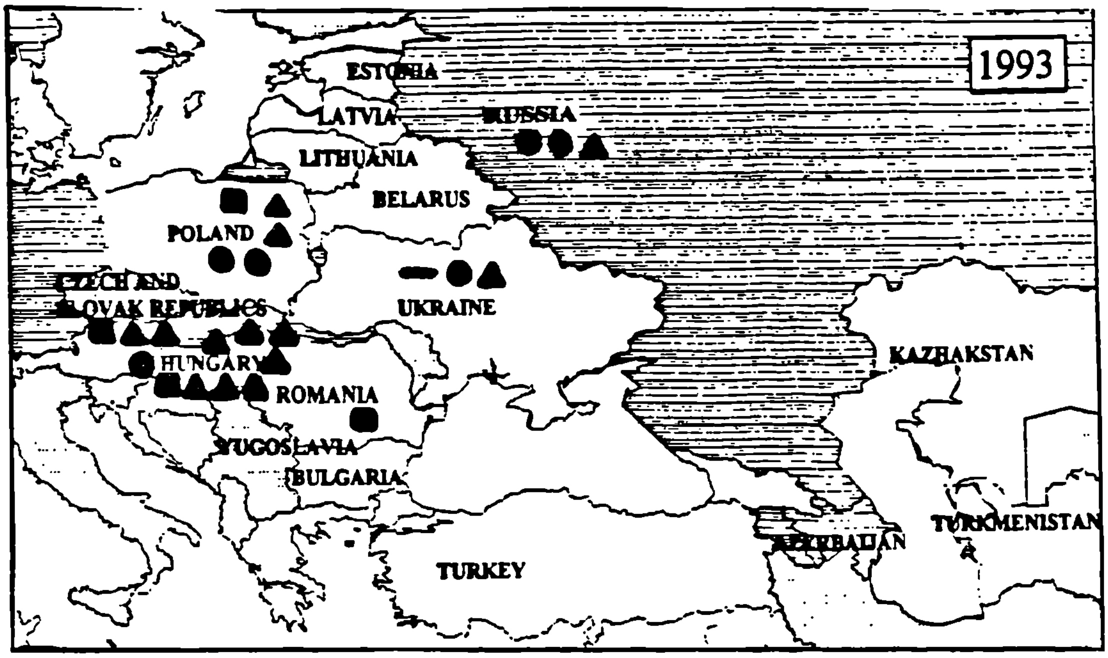


Figure 5.14

The mean size of a manufacturing subsidiary was £35 million. As in the tobacco industry, there additional cost is involved in modernising plants. The investment in modernisation, agreed in the initial contract, is $15.7 million. The only given figure for investment in a Joint Venture with a distributor gives an investment cost of $15 million. It must be noted that firms may make multiple investments in the same time period. Thus, actual investment in East and Central Europe for C3 in 1991 is given as $120 million. C2 invested $59 million in the region in 1991. Multiple investments may be made in the same country. C3 made two reported investments in Poland in 1993 for a total of $56.5 million. Data relating to mean investment size are summarised in Figure 5.15 below.

Sector	Financial Implications of Investment *Mean*
Low-margin Consumer Goods *Household Products*	£35 million initial investment plus $15.7 million modernisation. Total $50.7 million Possible multiple investments

Figure 5.15

When considering the investment activity of household product firms in Ukraine, it must be noted that some firms which appear to be late entrants may already have made large investments in neighbouring countries. These serve as manufacturing "hubs" for the surrounding region. Thus, if the investments in the region are plotted by level of commitment, differing strategies can be seen for serving the region (See Figure 5.14). C1 reports that its manufacturing facility in Ukraine is intended to serve the other former-Soviet states. C2 and C3 both serve the Ukrainian market with products manufactured in Poland or Hungary.

Accordingly, the importance of analysing the total portfolio of investments, which the firm has made in the region, becomes apparent. This seems to support Aharoni's contention (1966) that investment decisions are individual episodes in a broader pattern of investment activity (See Section 2.3).

5.4.3 Case Histories of mass-market consumer goods firms

Case C1

C1 is a family-owned American Multinational Corporation in the household cleaners and personal care market. Founded in 1886, the company is in its fifth generation of family ownership and went public in 1987. The family retained its ownership interest and voting control. By 1991 the firm had sales of $3,400 and 13,400 employees. C1 is traditionally a firm which adopts a pioneering approach to international expansion. In the 1930's, it was the first US chemical company to invest in South America. 75% of the firm's sales are now gained from its international operations. It has investments in 47 countries and distributors in an additional twenty.

In the early 1980's there were only three regions in which C1 was not present; India, Pakistan and the USSR. The firm began to look at ways of entering the Soviet Union, a key target for expansion. However, C1 has a policy of investing in a controlling interest in its subsidiaries and Soviet law prevented them from owning more than 50% of any joint venture. In 1988, the law on joint ventures changed. The limit on percentage of foreign investment was relaxed. Prior to the liberalisation of Eastern Europe and three years before the break-up of the Soviet Union, C1 began the process of finding a suitable joint venture partner. All negotiations had to be channelled via the Ministry for the Chemical industry, in Moscow. After meetings with a number of chemical plants, throughout the European part of the Soviet Union, a suitable partner was identified in Kiev, Ukraine in 1989. This was a state-owned producer of waxes and soaps, owned by the Ukrainian Chemical Association, a consortium of six chemical factories. The final agreement was signed in 1990.

C1 now has an 80% stake in a manufacturing joint venture. Its input consists of the investment necessary to update production facilities, marketing and managerial expertise. The local partner brought local knowledge, premises and staff, as well as a base level of production facilities. The plant has 330 employees, 200 of whom are in production. There are three expatriates, who hold the principle management positions, but hope to train Ukrainian staff in western business techniques.

The firm's strategy in entering Ukraine was simple: "to be there before the others and develop a volume/cost competitive advantage in order to build up strong barriers to late entrants." The implementation of this strategy involves:

- setting up a local production unit using local inputs in order to achieve low production costs
- to be able to compete in the local currency
- to develop market share in order to gain economies of scale
- to set up a network of partners for distribution and logistics
- to make products available in as large a geographic area as possible
- to build up strong brands, based on extensive distribution, affordable prices and high quality relative to local competition
- develop human resources in order to build tomorrow's management staff

C1 operates in local currency and attempts to price its products between those of indigenous suppliers and western imports. However, rampant inflation rates meant, at one stage, that they had to change their prices every two weeks.

The fortunes of the firm in Ukraine have been equally turbulent. When it entered the market, C1 was hard pushed to keep up with local demand levels:

> "Priced at roughly 30% of their western counterparts, [their products] were 'gobbled up' by 'a market screaming for new products.' Business Central Europe, February 1994.

It was then distributing through the old state-owned distribution system of "baza" (wholesalers) and "gastronom" (retail grocery stores). However, since April 1993, the factory has run at only 50 % of its capacity. This is not because of a decline in demand. The problems, which C1 is now facing, result from the transition process.

The structure of the former state economic system has gradually disappeared and no stable private sector has appeared to take it's place. Supply between wholesalers and retailers has now almost been severed. Little privatisation has taken place. In the absence of any proper distribution channels, a type of parasitic trader has developed. These traders take commission for arranging a deal, but there is no added value in terms of distribution. Furthermore, legislative measures change rapidly and can be draconian. The VAT levied upon the firm's products has fluctuated from 0% to 20% then 28% and now back to zero. Taxes can be up to 90% of revenue, not profit. One foreign investor in the market says that the conditions are so hostile that "it is like operating in the wild west." Bribery, corruption and organised crime are widespread.

In February 1994, the General Manager of C1 was uncertain as to the firm's future in Ukraine. He concluded:

> "There was a time when we thought Ukraine was the country with the best prospects in the Soviet Union. [Now] our arguments to the Board of Directors are much more subjective. I have no idea what will happen in Ukraine next year... We took a risk here, and its one C1 can afford. The question is: can we survive until Ukraine goes back up, and are we building up a competitive advantage in the meantime?"

Case C2

C2, a US-owned Multinational Corporation came into existence in 1837. It is a producer of household cleaners, personal care products, food, beverages and chemicals. Expansion abroad started in Canada (1915), the UK (1930) and the Philippines (1935). International expansion did not begin in earnest until 1945. The firm focused upon expansion into Europe. In 1991, C2 had sales of $27, 026 million and 94,000 employees. The firm had investments in 47 countries world-wide. 45% of its sales came from outside the USA.

The first reported activity of C2 in Eastern Europe was in November 1989, when it began negotiations in Russia. The first investments in the region did not take place until 1991, when the firm entered Poland via a distributor, set up a joint ventures in Moscow and Hungary and acquired a Czech manufacturing facility. In 1992, C2 invested in a detergents manufacturing plant in Russia. In 1993, they began work, on a greenfield site in Poland, to build a production facility for nappies. The firm has often made more than one investment in a country. These may be serial, in that they involve a higher level of investment, or parallel, in that they involve a different part of the company's product portfolio.

Investment in Ukraine took place in Autumn 1992. This took the form of a wholly-owned sales and marketing subsidiary. Currently, the firm has not begun to trade in Ukraine, but is prospecting for potential business. It is also seeking to build a network of distributors in Ukraine. In the early stages of market investigation, a manager from the USA ran C2. Responsibility has now passed over to a Ukrainian national, who previously worked for a multinational firm in the chemical sector.

C2 is hampered by the lack of reliable statistics, but have learned from experiences in the Russian market. It is difficult to study the market "scientifically". Understanding the psychology of the Ukrainian consumers is more important. It is accepted that a manufacturing investment would involve upgrading the production technology. There have been some quality problems in Russia during this process. Alternatively, products could be sourced from Russia or Poland, but they would incur import taxes. Moreover, C2 would be unlikely to gain a licence to sell in hard currency. There are strict conditions. Coupon sales are subject to 28% VAT. If imported products were sold at equivalent coupon prices they would be even more expensive than in western markets. C2 would only be able to gain a small proportion of the market.

C2's Ukrainian operation is answerable to the Frankfurt office. It also has a strong link with the CIS group, based in Moscow.

5.4.4 Summary of Data for Mass-market Consumer Goods

a) Demographic Data

Both of the cases in the household goods market are large, divisionalised multinational corporations. However, there is considerable variation in their size and scope. This does not mean that C1 should not be thought of as large and diversified, but rather that C2, ranked number 38 in the Fortune Top 50 firms in 1991, is one of the "mega-multinationals" (Humes 1993). Both of the firms have a matrix structure. They are divided both by product and by geographic region. Both are US owned, with a relatively high proportion of overseas sales. Each has a European Head Office, for C1 this is in London, whilst for C2 it is Frankfurt.

Sector	Firm	Size *Sales $ mill.*	 *No. of Employees*	Degree of internationalisation *Percentage of Sales Overseas*	 *Number of Countries invested*
Household	C1	3,400	13,400	75	47
Goods	C2	27,026	94,000	45	47

Figure 5.17

b) Entry into Ukraine

A distinction was seen between high margin firms (B1 and B2) and low margin, or mass market, firms (C1 and C2). The latter were more concerned about the price disparity of their products and local variants. Hence:

> "C1 price in Karbovanets (local currency). Their prices are high by local, though not by western, standards. They price on margin, conservatively, so as to survive. Inflation causes a problem. We have to change our prices every two weeks. We set up a local production unit to have low production costs and so that we can sell in the local currency. Our products are still expensive. There are no local equivalent products. Consumers use what they have and tend to use one product for everything. Shampoo is used for hair and fine fabrics (...) But because of the prices, Ukrainian housewives have unreasonably high expectations of products with a western brand. For instance, they expect a liquid detergent used with cold water to be as effective as a powder used with hot water." (C1)

The problem with achieving an acceptable margin if the firm does not produce in the market are even greater:

> "We are not currently doing business, but are prospecting for potential business. A major problem is that we would have to operate in hard currency. Licences are available to operate in coupons, but these must be granted by the government and the requirements are strict. The high rate of duty upon our products (28%) means that we cannot even charge the equivalent to coupon prices. As a result, we would be limited to doing a small amount of business through dollar stores, rather than serving the whole market." (C2)

In the Ukrainian market, where disposable incomes are low, some products will be seen as expensive, which would be mass market goods in advanced economies. Thus, even shampoos and detergents are luxuries. Different products for specific purposes have not previously been available in the market. A western firm, which operates in a consumer goods market, has two choices. If they are prepared to invest in manufacturing facilities in the market, they may succeed in penetrating the market. If they do not wish to make this investment, then they must adopt a skimming strategy.

Firm	Criteria for Entry	Date of Entry	Type of Operation	Number of Employees	Criteria for Expansion
C1	Market Potential	1988	Joint Venture Manufacturing	330	Success of - Current Venture
C2	Market Potential	1992	Representative Office	10	Assessment of Market Potential

Figure 5.18

5.5 Industry D - Industrial Products - *Chemical Industry*

5.5.1 Competitor Analysis

In the chemical industry, firms may focus upon one, or a number of stages, in the production process. There are a number of large rivals in oil and gas exploration. The global players include Shell, Exxon and BP. Whilst firms may be global in scope, they may have a strong base in oil distribution within their home country, examples include BP of Britain, Elf-Aquitain and Total, of France, and Italian Agip. The business of oil exploration is, however, focused on supply-side factors. The opening of East and Central Europe offers access to new resources. Significant attention has been paid to the availability of oil and gas in Siberia, Romania, Kazhakstan and Azerbaijan. Although there are also natural resources in other countries within the region.

The multinational firms involved in oil exploration may, also, have diversified vertically into manufacture of petro-chemicals. Examples include BP and Shell. In this market, they compete against other firms, who may be their own customers, or those of their competitors. In the latter category are firms such as ICI and Rhône-Poulenc. These firms are not interested in availability of natural resources, but in market size.

Firm	Size		Degree of Internationalisation			
	Sales $ m	*Number of Employees*	*Number of countries invested*	*Total number invest.*	*% of Sales ex home country*	*Length of international Experience*
D1	102,697	133,000	119	252	49%	124 years
D2	23,353	123,600	16	23	71%	65 years
D3	57,725	111,900	17	36	65%	86 years
D4	16,612	89,051	40	147	77%	75 years

Figure 5.19

Source: Hoover's Handbook of World Business 1993;
Hoover's Handbook of American Business, 1993.
Stopford Directory of Multinationals
Data are for 1991

The international activities of firms in oil exploration and refining tend to be geographically concentrated because of resource availability. However, market potential is a key driver for the chemical production side of the business.

The size of the largest international firms is greater than those in household goods and tobacco. Fortune 's Top 50 firms for 1991 puts D1 in second place and D3 ninth. The largest tobacco firm is ranked number 14, whilst the largest household goods firm stands at 20. However, the number of international markets, in which the chemical firms have investments, tends to be somewhat lower than for tobacco and household products firms. D3 has investments in 19 countries and D2 in 16 countries. Internationalisation often coincided with founding of the company, which was tied up with oil reserves outside the home country.

Sector		Financial Implications of Investment	
		Range	*Mean*
Industrial	Exploration	\$40 - \$50 million	\$45 million
Chemicals	Pipelines	\$400 - \$500 million	\$450 million

Figure 5.20

5.5.2 Investments in Eastern and Central Europe

The patterns of investment of these different types of firms might not be directly comparable. Thus the data are analysed in two distinct groups:

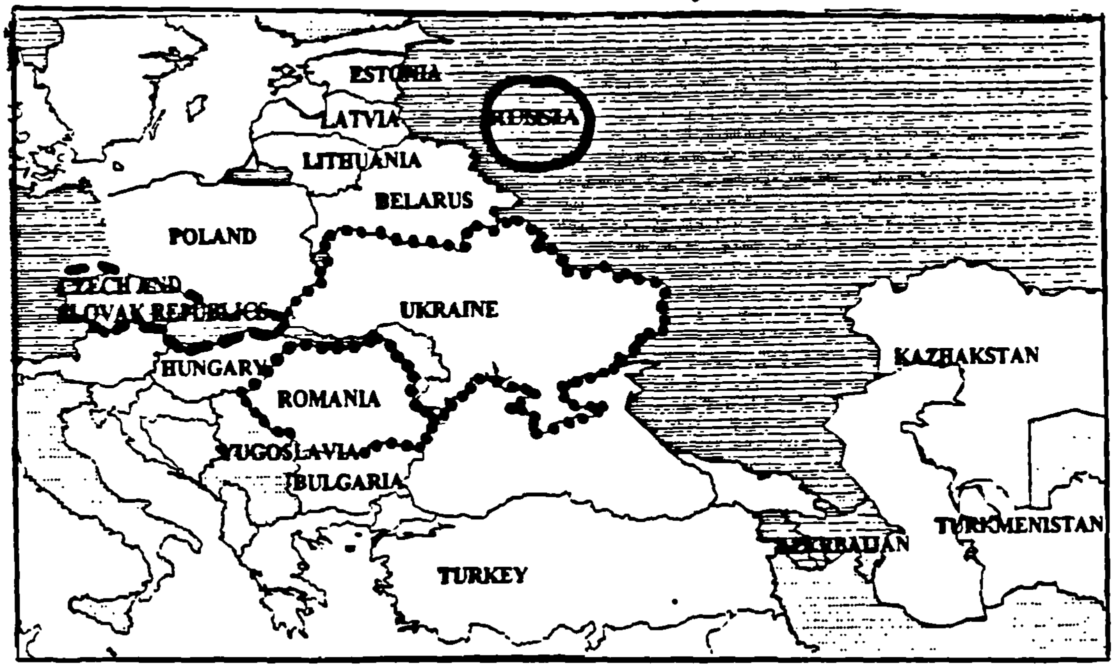
a) Firms involved in oil exploration and chemical manufacture
b) Firms only involved in chemical manufacture

	1989	1990	1991	1992	1993	1994
a) Firms involved in oil exploration and chemical production						
D1		Russia JV Manufacturing (Modest size) Russia S/M Office 100%		Romania Exploration Deal Ukraine Representative Office		Ukraine JV exploration
D3		Russia Sales Office	Czech Pipeline		Czech minority JV refining and pipelines July	
b) Firms involved in chemical manufacturing						
D2 1978 Moscow			Ukraine JV Agro-chemicals	Ukraine Representative Office		
D4 1970 Moscow Office		Poland 2 JVs Hungary 2 JVs	Ukraine Representative Agro-chemicals	Czech R JV 52%		

Figure 5.21

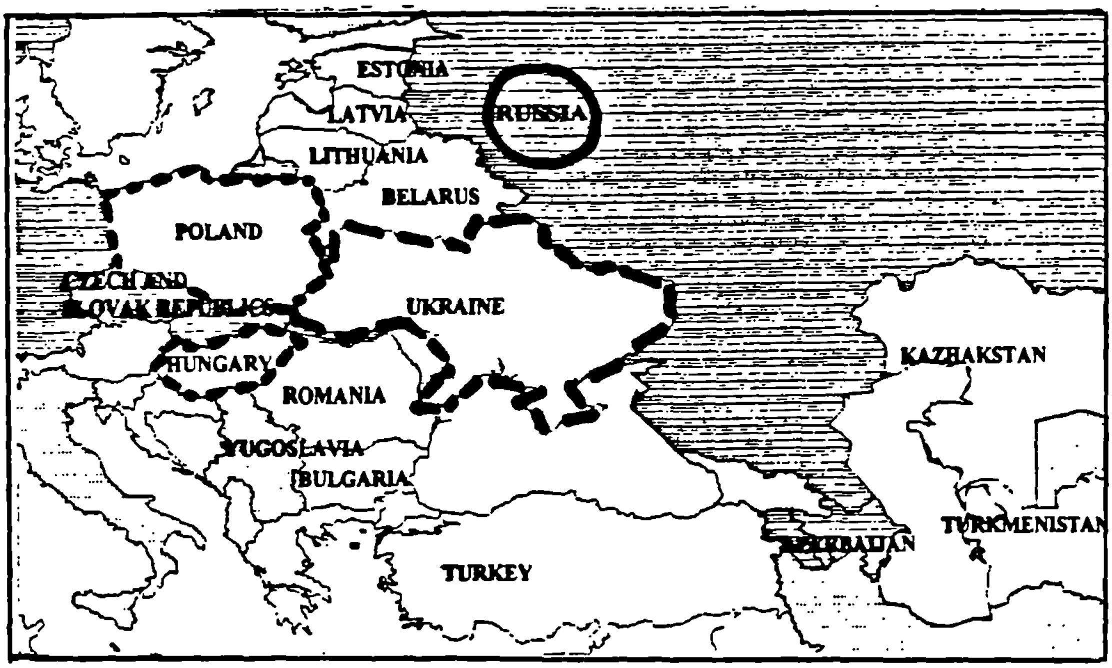
The patterns of investment for each group are shown in Figures 5.22 and 5.23. Those firms involved in exploration are influenced by markets with available oil. Those in chemical production are influenced by market size and stability, as in the previous sectors.

Firms involved in oil exploration and chemical manufacture



1990 1991 1992

Firms only involved in chemical manufacture



Firms tended to enter via low commitment modes of operation. Further investment followed an average of two years later. This incremental approach seems to relate to the size of investment.

5.5.3 Case Histories of Industrial Products firms

Case D1

Firm D1 was founded in 1907 as a result of an Anglo-Dutch merger. The firm is involved both in oil and gas exploration and in chemical manufacturing. D1 quickly became involved in international activities. Oil production began in Borneo in 1910, Mexico (1913), Venezuela (1914). The firm acquired interests in Romania (1906), Russia (1910), Egypt (1911), Trinidad (1913) and California (1915). The Eastern European investments were lost during the first world war. Further expansion took place in the 1920's and 1930's. The first production of chemicals began in the Netherlands in 1928 and in the USA in 1929.

By 1991, D1 had sales of $102, 697 million and 133,000 employees around the world. It had two hundred and fifty two investments in 119 countries and 49% of sales were outside Europe. A distribution network of petroleum stations had existed in Hungary since the 1950's. However, investment activity in Eastern Europe recommenced more fully in 1990, when D1 became involved in a manufacturing joint venture in Russia. This was described by the firm as being of "modest size". It was accompanied by the setting up of a wholly-owned sales and marketing office in Moscow.

In 1992, D1 signed an exploration deal in Romania. It was also in this year that the firm set up a representative office in Ukraine. The objectives of this office were to assess the market potential for speciality chemicals. The subsidiary had been approached several times as a potential joint venture partner. This had to be handled sensitively. Whilst this might be an option in the longer term, this would require a significant investment in the market. Therefore it would need more information.

Difficulties were experienced in making an accurate assessment of market potential. The capacity figures for production by the main Ukrainian plants varied, depending upon the source. Therefore, all information had to be cross-validated. Moreover, important pieces of information were missing. D1 could not establish who converts ethylene to polythene, although they know that this happens. Market research in Ukraine was described by D1 as tracing "chains of information", such as who produces a product, in what quantities, and where does it go next? Often there are vital links which cannot be established.

One trigger, which might prompt D1 to make an investment in Ukraine in the short-term, was the entry of a large international customer. Otherwise, they would continue to seek better market information. The firm was answerable to it's shareholders, therefore it could not afford to take unnecessary risks.

In March 1994, D1 were still present as a representative office. The market conditions were described as "shades of grey and black." Later in 1994, after the end of data collection, D1 invested in a joint oil exploration venture in Ukraine.

Case D2

In 1992, D2 was the fourth largest chemical company in the world. The firm is a British multinational. It was formed in 1926, as a result of the combination of four British companies. The first international involvement of D2 came through a 1929 patents and process agreement with a large American chemical firm. In 1931 and 1932, co-operative alliances were formed with a German partner. By 1991, D2 had sales of $23,353 million and 123,600 employees. 73% of the firm's sales were in international markets.

Investment activity in Eastern Europe began as early as 1978, when D2 set up an office in Moscow to co-ordinate activities in the region. On liberalisation, the firm began operating in the individual countries. In 1991, the firm set up a joint venture agreement in Ukraine. This was in the area of agro-chemicals. The following year, the firm also set up a sales and marketing subsidiary in the country to explore the market potential for other product categories. The interest in this, rather than other Eastern European markets, arose from its rich agricultural soils and large market size.

The worsening market conditions and legislative fluctuations have presented a number of problems for D2. There is a lack of reliable statistics to assess market potential. Problems have been encountered in gaining payment. Pesticides are often sold against a letter of credit. However, this causes cash flow problems. Furthermore, Kravchuk reacted to the economic crisis by banning the export of agricultural produce, causing significant losses for D2.

Case D3

D3 are also involved both in oil and gas exploration and in chemical production. It is a British Multinational Corporation, founded in 1909. The aim of its formation was to carry out international oil exploration. Until the Second World War, the firm was involved primarily in supplying oil, extracted in the Middle East. In the early 1950's, however, the firm began to expand internationally. New sources of oil were established in Nigeria. A network of refineries and distributors was set up within Europe. After gaining oil supplies from Alaska, the firm entered the US market in 1969. By 1991, D3 had sales of $57,725 million and 111,900 employees. It had 36 investments in 17 countries, which accounted for 65% of its sales.

D3's first investment in Eastern Europe came in 1990, when it set up a Russian sales office. In 1991, work began on an oil pipeline in the Czech Republic. In 1993, this was followed by investment in a minority stake in a refining joint venture and in pipelines. D3 does not currently operate in the Ukraine. In November 1993, the firm was considering entry with the speciality chemicals side of its business. It was also interested in the availability of gas in Crimea. An estimate was given that D3 would be in the lubricant market in Ukraine by January 1994. However, in

February of 1994, the firm still had not entered the market. At this stage D3 had decided that Ukraine represented too great a risk.

The explanation for this was as follows. Assessment of a new market opportunity happens at several levels. Firstly, there is a scientific assessment of the extent and availability of natural resources. At this level, Ukraine has potential. Secondly, there is assessment of the market opportunity. Ukraine is attractive because of its large market size. However, the likely returns on any investment are hampered in the short-term by the uncertainty of the market transition. At present, the implosion of the economy overrides the attractiveness of the market. Both Kazhakstan and Azerbaijan seem to have a greater short-term potential. Pending the outcome of the elections in Ukraine, in late March 1994, and signs of recovery in the economy, D3 decided to defer their investment decision.

5.5.3 Summary of Data for Industrial Products

The three cases in the chemical industry are all in Fortune's Top 50 Multinational firms for 1991. They are ranked at numbers 2, 9 and 49. All are British, or joint British and European in ownership and have a global scope of operation. However, such is the size of an investment in this industry, that they have operations in less countries, than do the consumer goods firms.

Sector	Firm	Size		Degree of internationalisation	
		Sales $ mill.	*No. of Employees*	*Percentage of Sales Overseas*	*Number of Countries invested*
Chemicals	D1	102,697	133,000	49	119
	D2	23,353	123,600	71	16
	D3	57,725	111,900	65	17

Figure 5.24

b) Entry into Ukraine

In industrial product markets, the firm may enter Ukraine either because it wishes to benefit from raw materials in the market, or else to tap the market potential. In this research, three chemical firms were studied. In the cases of D1 and D3, the firm wished to both of these with different divisions of its business. D2 was motivated by market size and factor availability.

The low labour costs associated with producing in Ukraine are attractive to firms, who wish to serve the market. However, as the quality and efficiency of Ukrainian manufacturing plants is low, production involves not only up-front investment, but transfer of technology and managerial skills. Raw materials such as gas, coal and metals are currently available at less than market price. These may be of interest either as exports, for use in other countries, or else for conversion into secondary goods within the Ukraine. Export and import are subject to the vagaries of changing legislation. Currently, the export of goods is considerably restricted by legislation. However, it may be possible in the future to transfer goods effectively in and out of Ukraine.

Firm	Criteria for Entry	Date of Entry	Type of Operation	Number of Employees	Criteria for Expansion
D1	Market Potential	1992	Representative Office	4	Assessment of - Market Potential/ Entry of International Customer
D2	Market Potential	1991	Representative Office and Joint Venture	3	Success of Current Ventures
D3	No Entry		-		Improvement in Ukrainian Economy

Figure 5.25

5.6 High-Tech Industrial Products - *Computer and Telecommunications*

5.6.1 Competitor Analysis

The computer industry is global to the extent that most of the "boxes" are now made in locations with relatively cheap labour, such as in South-East Asia. Whilst East and Central Europe may ultimately be of interest for production, currently there is insufficiently advanced production technology. Consequently, the markets of East and Central Europe are being contested by computer firms for their sales potential. These sales tend to come from modernisation of the retrograde infra-structure. This represents a significant new market opportunity for a computer industry, which has seen a levelling of sales growth going from the buoyant 1980's into the 1990's. There are a number of large, global players in the computer industry. The firms analysed in Figure 5.26 are those, which are most active in Eastern and Central Europe.

Firm	Size		Degree of Internationalisation			
	Sales $ m	*Number of Employees*	*Number of countries invested*	*Total number invest.*	*% of Sales ex home country*	*Length of international Experience*
E1	2,624	24,258	39	85	*	60 years
E3	13, 911	121,000	31	58	60%	39 years
E4	64,792	344,533	42	61	62%	75 years
E5	14,494	89,000	32	64	56%	55 years

Figure 5.26

Source: Hoover's Handbook of World Business 1993; Hoover's Handbook of American Business, 1993 Stopford Directory of Multinationals. Data are for 1991

* Data Unavailable

5.6.2 Investment in East and Central Europe

E1, E4 and E5 had significant experience in exporting to the region prior to liberalisation. This was controlled centrally via Moscow. However, the firms also had export representatives in Hungary, Poland and Czechoslovakia. Since liberalisation, expansion in the region has been rapid (See Figures 5.27 and 5.28). Firms have increased their level of investment rapidly, especially in Hungary, Poland and the Czech Republic. This rapid growth rate may relate to a high volume of sales gained through contracts both with Western aid agencies and host country governments. Investment behaviour in the computer industry appears, in many respects, similar to that of financial services.

Large contracts are frequently reported in the press:

> "A tender issued by the Customs and Excise Guard for computerisation of the customs administration under the PHARE aid programme has been won by A3 of Hungary. The contract is worth a total of about $6 million." (BBC Monitoring Service, Eastern Europe 12/08/93)

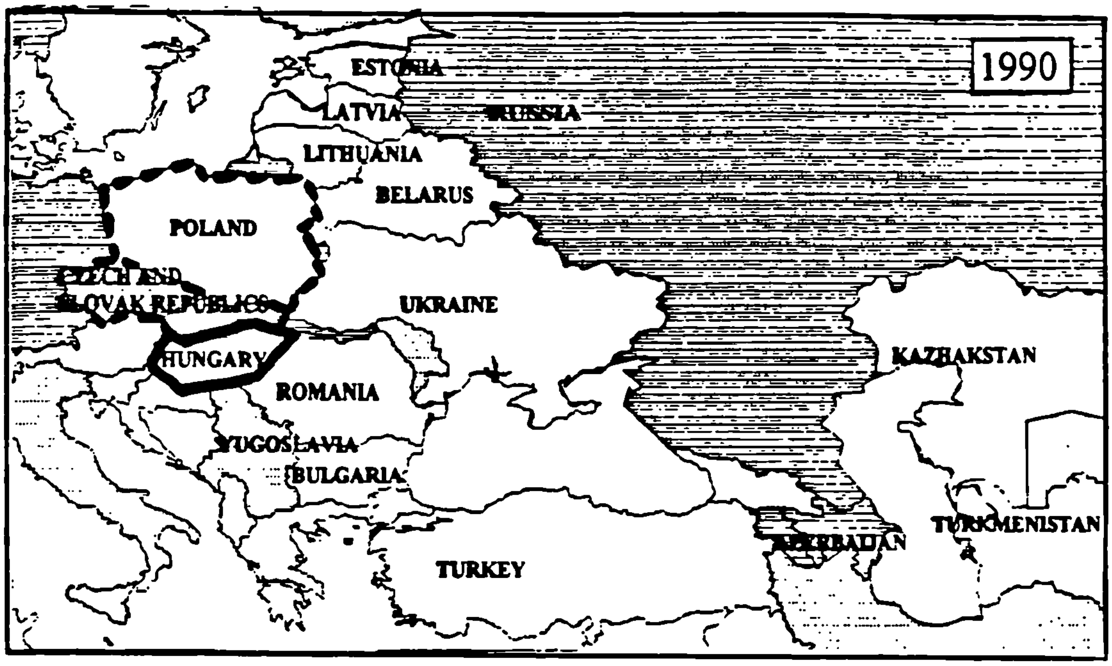
> "Computer giant E4 and the Polish Cabinet Office (URM) have signed a wide-ranging agreement, according to which E4 will computerise the state administrative apparatus." (Rzeczpospolita 27/07/93)

> "E5 has won orders to computerise several Polish state and government institutions, including the Central Office of Statistics (GUS), a $1.5 million contract in the first stage; the Sejm $1 million, the National bank of Poland $ 1 million in the first stage; the Forestry Authority (ZLP) $14 million." (PAP Business News from Poland, 28/06/93)

Sales are largely dependent upon the award of such large, infrastructural contracts. Some of these are host market funded, but a number rely, at least in part, on western aid agencies. Sales growth has been rapid leading to more rapid expansion than originally foreseen:

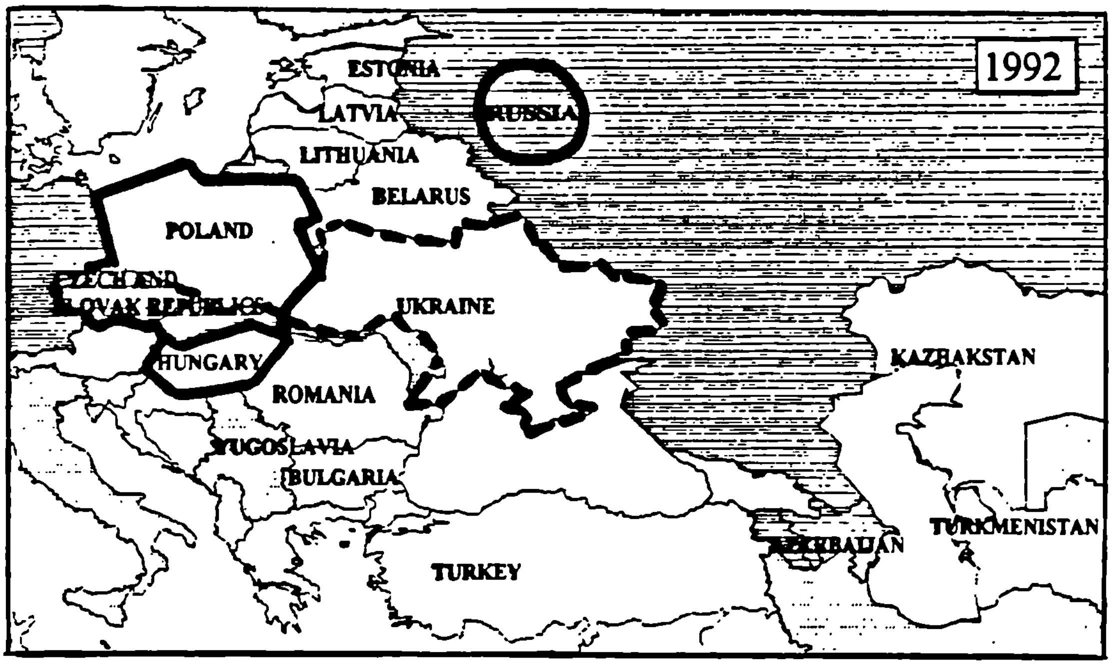
	1989	1990	1991	1992	1993	1994
E1	20 years experience in USSR Operation in Hungary 1964 Poland Exports for over 20 years	Hungary JV Budapest Poland Sales and Marketing Czech Republic Sales and Marketing	Hungary 100% Debrecen September	Hungary (Pecs) Russia JV 60% Manufacturing Kazhakstan Ukraine Distributor Bulgaria Romania		
E3		Hungary JV 51% - 63% April	Hungary 100% bought out 2 partners Czech Export 07/03/91	Ukraine 100% Poland 20/01/92 Russia Sales and Marketing 100% Czech Republic 23/01/92	Hungary PHARE $6 million contract	
E4	Moscow over 20 years Hungary since 1936 Parent in Czech for 20 years		Poland October 100% Czech R 25/01/91 5 offices Russia Sales and Marketing 100%	Hungary JV Russia 100% Sales and Marketing	Lithuania Ukraine 01/04/93 Czech expansion + 4 cities 21/05/93 Bulgaria JV 01/04/93	
E5	Hungary 1987 Czech R Export 1971 Export rep 1975 Poland Distributor	Hungary Ltd Company	Hungary 100% Poland 100% S/M	Hungary		

Figure 5.27



Three or more firms with high levels of investment

One to three firms with high levels of investment



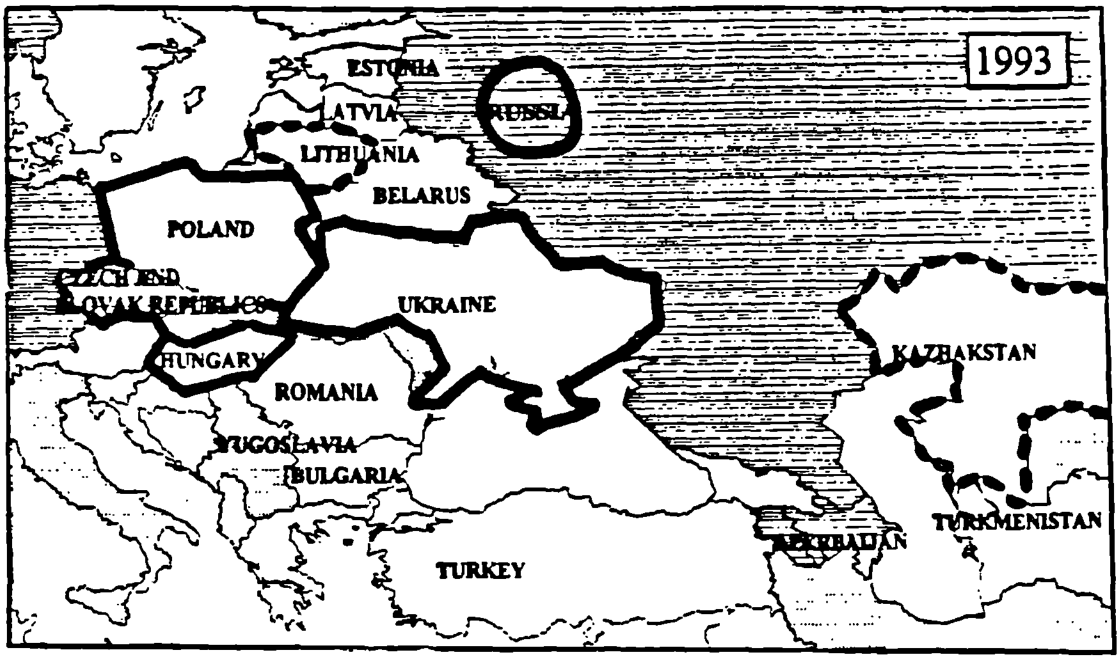


Figure 5.28

It is said of E4:

> "Current annual sales in the five reforming countries Bulgaria, Czech, Hungary, Poland, Romania and former Yugoslavia are around $300 million" Reuters 03/06/92

E5 set up a representation in Hungary in 1987. In 1990, revenue grew by 73% and a further investment was made in a Limited Company. This was set up as a minority Joint Venture in April 1991. A further increase in revenue in 1991, to give sales of $15.7 million, resulted in the decision to take 100% ownership of the subsidiary in August 1992. The reason given for the purchase is that sales had grown more rapidly than envisaged:

> "At the time of creation of the JV, E5 was offered a five-year option to buy out Controll's stake. A company spokesman told Econews that it is proof of the success of the company that the buy-out took place much earlier than planned." (MTI Econews, 24/07/92).

The history of the development is explained as follows:

> "E5 first set up an office in Budapest in 1987, but following political changes in 1990 decided to increase its presence. The result was a joint venture with Controll (...) established in March 1991 with equity of 50 million forints, of which E5 owned 35%. In its first year, the JV increased E5 sales by 73%, partly because HP brought out a lot of new products in that year, and partly because the JV became the focus of all the tax benefits open to a foreign-owned company (...) Sales up to October 31st will register a further 45 - 50 % rise, so that 1994's sales targets have already been achieved. E5 recently exercised its right to buy out Controll because - as a result of the rapid expansion in sales - the JV had reached the point where major financing was required." (Heti Vilaggazdasnag 03/10/92)

Similar growth has been experienced by other computer firms in the Central European markets, resulting in rapid expansion. However, in addition to sales growth, an additional impetus may be the relatively low cost of investment. The equity stake of E5, in taking 100% ownership of its subsidiary, was $700,000. The cost of a 45% stake in a Joint Venture in Hungary for another firm in the sector was $113,000. The maximum reported investment in this sector was $2 million by E3 in a Joint Venture in Hungary. This could be offset by gaining a single contract.

Sector	Financial implications of investment	
	Range	*Mean*
High-technology Industrial *Computing/Telecommunications*	$113,000 - $2 million	$937,600

Figure 5.29

5.6.3 Case Histories of High-technology firms

Case E1

Firm E1 is a British-based multinational producer and distributor of computers. It has over 60 years of international experience. 80% of E1 was acquired by a Japanese firm in 1990, the remaining 20% is Canadian owned. With sales of $2,624 million and 24, 258 employees in 1991, E1 is the largest software and computing services firm in Britain. It has 85 investments in 39 countries. Furthermore, there are a large number of associated investments through its Japanese parent.

In Eastern Europe, E1 has a broad portfolio of investments. It has a direct trading subsidiary in Russia, which distributes the company's products. It also has a joint venture to assemble computers. There are wholly-owned subsidiaries in Poland, the Czech and Slovak Republics, Hungary, Bulgaria and Romania.

E1 had links with three of these markets before liberalisation. It has twenty years of experience in the USSR. It has had a distributor in Hungary since 1964 and has exported to Poland for more than 20 years. The years since liberalisation have brought an increase in the level of investment activity of the firm in Eastern Europe. In 1990, it invested in a Joint venture in Hungary, additional offices were established in Debrecen in 1991 and in Pecs in 1992. Sales and Marketing subsidiaries were established in Poland and the Czech Republic in 1990. Investments in Bulgaria and Romania followed in 1991. In Kazhakstan, E1 has a licence agreement for the production of PCs and mid range systems.

In Ukraine, E1 established links with an independent distributor in 1992. This choice of entry mode is seen to provide the benefits of local knowledge and to buy time, whilst the firm assesses the market potential. It is foreseen that a joint venture agreement might be entered into in Ukraine, dependent upon market potential. Clearly, there is an opportunity in Ukraine. The temptation is to rush in, but the costs of setting up the operation are too great. E1 would expect the investment to pay back within two to three years.

E1 has links with local education providers in Kiev. There are high levels of information technology skills in Ukraine. Information gained through these channels is seen to be much more valuable than the secondary data which can be accessed from outside of the market. Such reports are helpful at a basic level, but they are general and become out of data very rapidly.

Within Eastern Europe, E1 has links with regulatory bodies such as the EC. Contracts from these regulatory bodies are one possible source of revenue. Gaining a major contract, or else finding an attractive joint venture partner would be seen as good reasons for making an investment in Ukraine. In March 1994, E1 were still considering the possibilities for expansion. The prospects seem good.

Case E2

Firm E2 was formed by the merger of the telecommunications interests of two large British firms in 1988. In 1989, one of the multinationals took a 60% stake, after a bid by the German electronics firm, which now holds the remaining 40% of the company. Hence the majority of E2 is owned by a large British Multinational electronics corporation, established in 1968. The parent company expanded into Europe and the USA in the late 1960's. By 1991, it had sales of $13,479 and 118,529 employees. 44% of sales were outside the UK.

E2 has 22 investments within the UK and is looking to develop its own international portfolio. One respondent suggested a risk-averse climate, when it comes to international expansion. However, the decline of its cash cow in the UK dictates rapid entry into markets, which are less technologically developed. The firm has a successful joint venture in Moscow. Ukraine was seen as the next development. The firm had been studying the potential of Ukraine for two years before winning a contract to supply the Ukrainian government with equipment to modernise the telecommunications infrastructure. An export representative went out to Ukraine in 1993. Since then, he has been assessing market potential.

In March 1994, the representative in Ukraine was about to leave the country, en route to a new posting in Azerbaijan. Azerbaijan and Kazhakstan were now considered to be of greater interest than Ukraine. E2 were withdrawing in the face of worsening market conditions. There was business to be gained. However political instability, bribery and corruption were such that the parent company felt that the risks of operation in Ukraine were too great at present. Larger competitors remain. They are looking at longer-term potential.

5.6.4 Summary of Data for High-technology Cases

a) Demographic Data

One firm from each of the computing and telecommunications industries were studied. Both of the industries involve high-technology products with a significant requirement for after sales support. In the global industries, in which they operate, both of the firms count as small players. However, they are still large multinational firms. One of the firms is British owned. The other is 80% Japanese owned. Therefore, again nationality is difficult to determine.

Sector	Firm	Size		Degree of internationalisation	
		Sales $ mill.	*No. of Employees*	*Percentage of Sales Overseas*	*Number of Countries invested*
Computing/	E1	2,624	24,258	*	39
Telecommunications	E2	13,479	118,529	44	14

Figure 5.30 * Data Unavailable

b) Entry into Ukraine

As shown in the investment announcements relating to Eastern Europe, the computer firms are significantly influenced by the availability of large government contracts. In this respect, a similarity can be seen between the computer and telecommunications industries. In this study, these are grouped together, as they both involve high-technology industrial products. High-technology industrial products are subject to a different set of issues to the chemical industry. Often, they require a high level of service support, and this influences entry mode choices. Also, as such products are involved in improving the infrastructure of Ukraine, these firms, like business-to-business services are likely recipients of government-funded contracts.

Firm	Criteria for Entry	Date of Entry	Type of Operation	Number of Employees	Criteria for Expansion
E1	Market Potential	1992	Distributor Office	4	Assessment of - Market Potential/ Entry of International Customer/ External Funding
E2	External Funding	1993	Export Representative	1	Assessment of Market Potential

Figure 5.31

5.7 Chapter Summary

The key drivers of expansion into East and Central Europe are studied for firms in the financial services, tobacco, household products, chemicals and computing industries. The size and motivation for investments is explored, using the firms' press announcements of investments. These were drawn from a Reuters press search. The criteria for entry into Eastern Europe are explored for each of the sectors. Comparisons are drawn between the level of investment, which is required by each. It is seen that financial services firms may have external funding or a guaranteed level of business with existing customers. Similarly, firms in the computing industry are often recipients of contracts for redevelopment of the infrastructure. The level of investment involved in market entry, in both of these industries is significantly lower than that required in the consumer sectors studied. It is also significantly lower than the investments made by chemicals firms.

Investment in the region is seen to have moved progressively further east since liberalisation. Study of the overall portfolio of investment shows that, in industries, where low levels of investment are required, there is a tendency to have offices in each of the countries. This pattern applies to business-to-business services and to high-technology industrial products. It may also relate to the need for on-site support, or to concern over quality standards.

For consumer goods firms, manufacturing within the region is important for cost reasons. Given the size of investment involved in setting up a manufacturing plant, firms may not invest in every country. Instead they operate from regional "hubs." Chemical firms are influenced by the availability of oil and gas. The size of investment required by the exploration side of their business requires the highest level of financial investment seen.

Case histories of the firms studied in this thesis are presented under the headings of business-to-business services, high-margin and mass-market consumer goods, high- and low-technology industrial products. Data are summarised in tabular form.

Chapter 6 - Cross-industry Analysis of Entry Decisions

This chapter analyses entry decision data across industry sectors. It employs a process of pattern-matching by iterative tabulation of data (Miles and Huberman 1984). The richness of the data is explored more fully using verbatim quotations from case respondents and secondary sources. Entry decisions are analysed as to the criteria for entry, acceptance of risk and level of commitment. Typologies of decision-making behaviour are identified. Four groups are distinguished, who have made different choices relating to these key variables.

6.1 Criteria for Investment

In thirteen cases, firms had decided to make an initial investment in Ukraine. The criteria for this investment can be categorised as follows:

Market Size	)	
Factor Advantages	)	*Market Potential*
Geographic Location	)	
External Funding Opportunities		
Service to International Customers		
Competitor Activity		

Literature proposes a variety of frameworks for analysis of the "triggers" to entry. They can be classified as proactive or reactive (Olson and Wiedersheim-Paul 1978):

Reactive	*Proactive*
Unsolicited Order	Geographic Location
Entry of International Customer	Factor Advantages
Actions of Competitor	Market Potential
Government Contract	

Figure 6.1

Another way of looking at the criteria for entry into Ukraine, is to identify their origin in the environment surrounding the firm. They may come from either the primary or secondary task environments (Achrol, Reve and Stern 1983). By this classification, market size, geographic location and factor advantages are influences in the secondary or macro-environment, whilst customer, competitor and regulatory influences, come from the primary or micro-environment of the firm (See Figure 6.2).

6.1.1 Market Potential

Eight of the firms (B1, B2, C1, C2, D1, D2, D3 and E1) were attracted to Ukraine by market opportunities offered by liberalisation. This includes all of the consumer goods and chemical firms and one high technology firm. Only one firm, (C1) in the household goods sector, was already involved in joint venture negotiations before liberalisation. Negotiations began in 1988 and the joint venture continued, despite the demise of the Soviet Union, in late 1991.

A number of firms had previously dealt with the Soviet Union. One chemical firm explained that they had had:

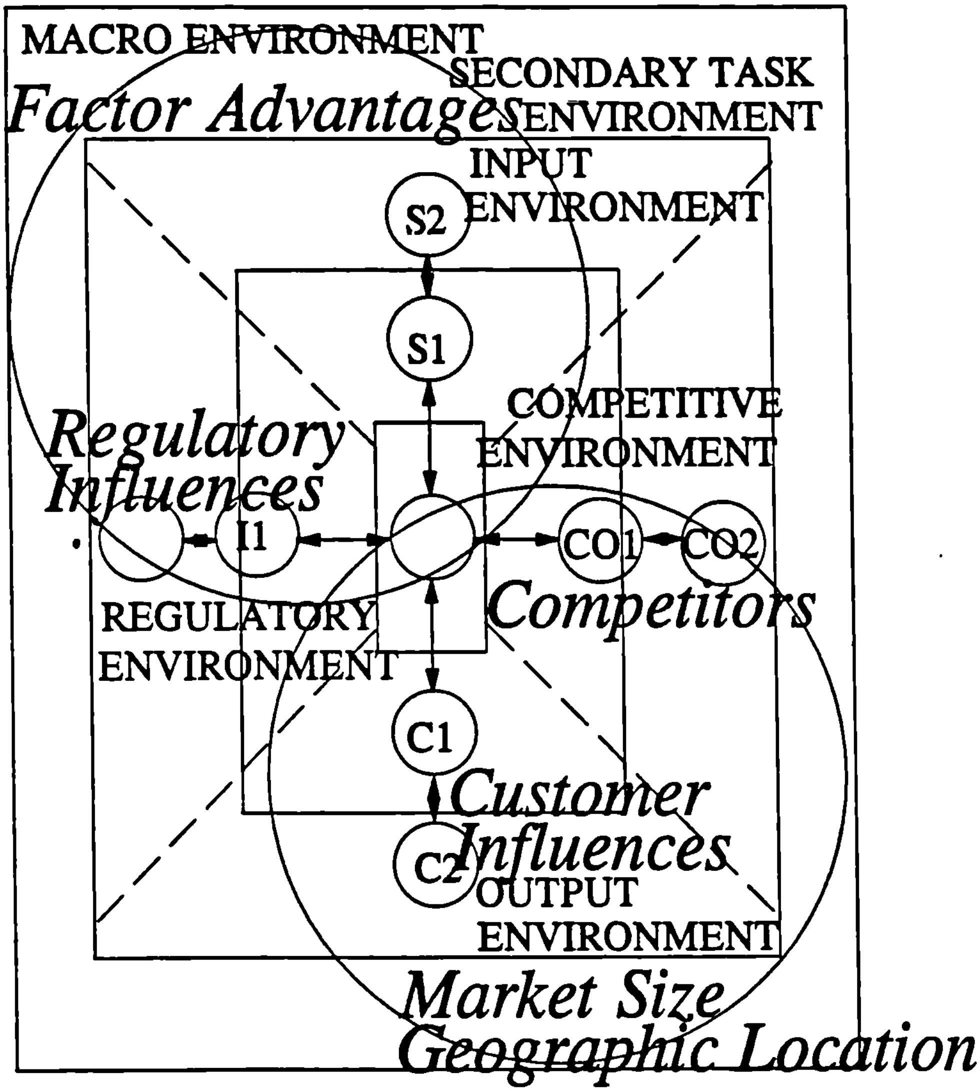
> "a Moscow Office for 15 years. This served the entire Soviet Union, as everything was done centrally." (D2)

Similarly, a consumer goods firm had previously exported to the Soviet Union from the UK:

> "We previously dealt with the area, but everything was handled centrally in the Soviet Union. Consequently, there was little knowledge of how the system worked and none about the different countries which now exist" (B1):

Market potential was comprised of the size of the available market in Ukraine, geographic location as a gateway to Russia and factor advantages.

Major Influences upon Investment
Decisions in Ukraine



I = INTEREST GROUP　　CO = COMPETITOR
C = CUSTOMER　　S = SUPPLIER

Figure 6.2

a) Market Size

A population of 52 million people, who are "short of absolutely everything" (C1), represents a significant opportunity to firms in mature industries. On liberalisation, the potential of Eastern Europe was widely heralded in press coverage. A Financial Times study of retailers entering the area (October 12th, 1992) stated:

> "The prospect of converting 400 million eager consumers into loyal shoppers is encouraging many retailers to invest in the region"

Ukraine, in particular attracted attention (Deutsche Bank 1991, Europe 1991, Euromoney 1992). Basic demographic research showed it to be a "large available market". As such, it was of particular interest to firms in consumer goods industries. The tobacco market in Ukraine, for example, is both large and growing (See Figure 6.3):

	Market Size
CSFR	31 billion
Hungary	20 - 25 billion
Poland	90 - 95 billion
Russia	300 billion
Ukraine	40 billion

Source: Reuters 24/09/91 Figure 6.3

However, the actual market potential is difficult to establish. For cigarettes, as for many other products, data obtained from official sources varies dramatically. The Trident Consulting Group's figures for cigarette production give 69.3 billion units in 1991. An additional 600 million cigarettes were imported from Moldova. Thus, their calculation of market size differs from Reuters by 29.9 billion units!

In the drinks industry, firm B1 says of its experiences in Central Europe:

> "It has very much been a case of 'do it yourself'. For example, no official records exist of wine and spirits retailers (...) so our people literally had to map out their markets themselves." Official Press Release

Similarly, in the chemical industry, case D2 explains:

> "Some figures, such as output are available. However, trying to track down market size is complicated by the problem of 'inter-dependent links'. If one vital piece of information is missing, such as what products are being converted into or where they are sold, then the chain is broken" (D2)

However, for some firms, given the available markets in Eastern European countries, even skimming the market is potentially interesting:

"Even 1% market share of 300 billion cigarettes is worth having" (B1)

However, capitalising upon the size of the market is fraught with problems. An entrant prior to the demise of the Soviet Union, C1 have suffered a reversal of fortunes:

> "At first, C1 could not keep up with local demand for its lines of household cleaners, polishes and detergents. Priced at roughly 30% of their Western counterparts, they were gobbled up by a market 'screaming for new products'. But since last April, the factory runs at 50% capacity. Consumer demand hasn't flagged [says their General Manager]; the problem now is distribution. " Business Central Europe February 1994.

As the previous system breaks down, market size alone is insufficient to guarantee success.

b) Factor Advantages

Ukraine has a number of factor advantages. It has rich agricultural soils, metals, coal, oil, natural gas and low cost, relatively highly skilled labour (Manninen and Snelbecker 1993). This led to the development of a strong industrial base. The system of specialisation in the former Soviet Union meant that this was not necessarily based on factor advantages, or disadvantages, as in free market economies (Porter 1990). It might be in areas designated by the centrally-planned system. Hence, Ukraine has a significant oil refining capacity (65 million tonnes), although it has relatively little oil. It also has a large proportion of the nuclear power generation and chemical industries. Firm D3, in the chemical industry, explained that one stage of assessing market potential is to look at the "scientific case". On this basis:

> "there is sufficient oil and gas in Ukraine to make it interesting to a multinational firm."

Ukraine is also attractive to some firms because strong local demand has developed skills in a particular sector (Porter 1990). There is a large demand for vodka and skills in distilling it:

> "The portfolio [of products launched] in Ukraine will be similar to that of (...) affiliates in Hungary, Czechoslovakia and Poland - with one difference, a local vodka. Vodka is the major distilled spirit category in Ukraine and the "granary of Europe," as it has been called, has considerable expertise in the production of vodka." (Press release, December 1992 B2)

This demand is derived from the factor advantage of good agricultural soils, which made Ukraine the largest producer of grain and of 53% of the sugar in the Soviet Union.

The value, which firms perceive in these factor advantages is clear. Manninen and Snelbecker's research (1993) shows cheap materials (32.1%) and low wage levels (24.5%) as the third and fourth highest motivations for entry into Ukraine (See Figure 4.4).

However, the Economist (May 7th, 1994) urges caution to those investors, who believe that the industrial past of Ukraine confers value:

> "Thus one big illusion: that Ukraine is a wealthy place. Two and a half years [after independence], a majority of Ukrainians still have not come to terms with the fact that most of their Soviet era dinosaurs are a liability, not a legacy".

c) Geographic Location

Geographic location also contributes to the market potential of Ukraine. On the break-up of the Soviet Union, Ukraine was considered to have the greatest potential for reform to a free market economy, as it was:

> "bigger than all the rest [of the former Soviet States] bar Russia. It had stronger hopes of quickly establishing ties with the rest of Europe than, say, Kazhakstan. And it had inherited a disproportionate amount of the former Soviet Union's industry" Economist, May 7th 1994.

Ukrainian independence took place at the end of 1991, whilst liberalisation in the Central European countries of Hungary, Czech and Slovak Republics and Poland had occurred late in 1989. Therefore, many of the firms had already established positions in Central Europe before considering the prospects in Ukraine. As Ukraine was seen to have better prospects for reform than Russia and the Southern republics of Azerbaijan, Armenia and Kazhakstan, it represented a "gateway to the East."

> "Using the experience gained in the Ukraine market, B2 will then expand its operations in Russia, a market three times the size with a population of three million."

6.1.2 Government and aid agency funding

Two firms in the financial services sector (A1 and A5) gained foreign aid contracts, during the period of data collection. Another financial services firms (A1) was strongly motivated to enter the market by its developing relationship with the EC. The decision to enter Ukraine was influenced by the company's involvement with the EC's Technical Assistance to Commonwealth of Independent States (TACIS) project. This connection is centred around a direct relationship between the company's Brussels subsidiary and the EC. Moreover, it also has links with the World Bank, via its Washington Office. These relationships with Western aid agencies are the main criteria for its entry into, and establishment of subsidiaries in, a number of Eastern European markets.

A complex round of bids to funding bodies, such as the EC, may result in contracts being awarded for markets, in which the co-ordinating firm does not currently have a representation. In one instance, a consortium of firms had their bid accepted by the EC. However, this was matched with an institution in Ukraine, rather than in Russia, which had been the original bid. In another case, the development of a multinational consortium, which had worked together successfully on a contract in Ukraine, resulted in applications for other grants. The choice of target market for the bids was influenced by which markets were receiving funding at the time. This transfer of bids across markets may not even be restricted to bids within East and Central Europe, but also led, in the case of E5, to an application for contracts in Vietnam and China.

External contracts may specify minimum levels of investment, as they require the provision of certain facilities by the co-ordinating firm.

Firm E2 were also attracted to Ukraine by government funding. However, in this case, the contract was from the Ukrainian government for modernisation of the existing infrastructure:

> "We had an agreement with the government to modernise their [system] and have supplied them with [products] worth $54 million."

6.1.3 Service to International Customers:

Another source of influence was the entry into the market of a major international customer. This was the primary motivation for three Business-to-Business Services firms (A2, A3 and A6). By Erramilli's definition (1989), the business-to-business services firms, who deliver consultancy and financial services, are "hard service" providers. The service which they provide can increasingly be separated from its provider, especially with improvements in technology. In that sense, it would be possible to export the service, or supply it from a subsidiary in a geographically-proximate market. However, the quality of service delivery is an issue, to all of the firms in service industries. High levels of competition mean that provision of a consistent level of service to international customers was a universal concern. The initial interest in eastern Europe was variously attributed to the actions of major customers:

> "To serve major customers" (A2)
>
> "because of a number of requests from clients" (A3)
>
> "Business is centred mainly on international clients. A2 must offer world-wide service in order to develop relationships with these clients across markets (...) we followed major clients (...) into the market, with whom we have long-standing relationships in many markets."
>
> "In 1988, the Firm assisted one of its multinational clients in the establishment of one of the first joint ventures in Ukraine, in the personal hygiene area. The Firm opened its Kiev office in 1992, when Oleg Batyuk returned to Kiev after a year of working with members of the Firm in London." (A6)

However, it is also related to the actions of other industrial firms. Alongside the motive of market potential, one chemical firm stated that they would increase their level of investment in Ukraine:

> "if one of their major customers, currently operating in Czech Republic and Hungary, were to enter Ukraine" (D1)

6.1.4 Competitor Activity:

All of the firms spoke of their entry into the market in terms of the actions of their competitors. They wished to gain first-mover advantage over their competitors, to gain their share of available government funding, or to gain the best of the natural resources. This was considered particularly important by consumer goods firms. One early entrant into Ukraine described their aims as follows:

> "to be there before the others and develop an volume/cost competitive advantage in order to build up strong barriers to late entrants (...) to invest in the development of a strong presence now, in the hope that late entrants will have to spend more to build a defensible position, when the market becomes attractive." (C1)

Another (B1) suggested that the Ukraine was "one of the last virgin territories to be contested."

This preoccupation with the actions of oligopolistic rivals was not restricted to the Ukraine, but related to other investments within Eastern Europe. The rivalry has been intensified, in some industries, by the system of bidding for firms in newly-privatised industries. Thus, one firm suggested that they were keen to invest in the Ukraine because they had "lost out" in bids for investment targets in the Czech republic and Poland. This competition for investment opportunities has escalated such that one firm had reported a rival for investigation by Monopolies and Mergers Commission. Investment in Ukraine cannot be considered in isolation from the portfolio of investments which the firm had made. Nor can the decisions of each firm be seen in isolation for those of its competitors. The investments in Ukraine were seen as the "next move in a global chess game" (C1) or as "jockeying for position" by global rivals (C2) (See Chapter 5).

6.1.5 Primary and Secondary Motivation

In many cases, there was more than one motivation for entry into Ukraine, which can be divided into primary and secondary aim. One of the financial services firms, for example, entered the market to provide a service to existing customers, but had the secondary aim of growing in the market through external funding (A2). A household products firm entered the market for its size and geographic location, but also wished to take advantage of low labour costs (C1). It manufactures products in Ukraine at a price that allows it to penetrate the market. Importing goods from plants in other countries would be impossible, in any case, as:

"it would have been too expensive because of high import taxes."

Having more than one criteria may also relate to the activities of different divisions of a business. Thus, for one of the chemical firms (D2), rich agricultural soils offer a good market for agro-chemicals, whilst the large market size creates potential for speciality chemicals and pharmaceuticals. Gas and oil in Ukraine are of interest to another chemical firm (D3), whilst market size is of interest for its speciality chemicals and lubricants division.

The criteria for the entry decision of the thirteen firms, which have invested in Ukraine are summarised in Figure 6.4. There are two firms which have not invested in Ukraine. These are A4 and D3. The reasons for this differ. A4 is in the same industry as a number of firms, which have invested in Ukraine. It has investments in other East and Central European countries. However, at the time of data collection, it was not contemplating investment in Ukraine. Operations in other markets in the region have:

> "mainly opened up to service western Multinational Corporations. The size of the office is determined locally, dependent upon the level of business." (A4)

Currently, there is not a sufficient level of business to justify a separate operation.

However, D3 is actively considering investment in Ukraine. In November 1993, it was not present in the market, but it was in the process of assessing market attractiveness. An investment was scheduled for January 1994.

Sector	Case	Primary Motivation	Secondary Motivation
Financial Services/ Law	A2 A3 A5	Customer Service	Market Potential/ External Funding
Financial Services/ High Technology	A1 A5 E2	External Funding Available	Market Potential
Consumer (High Margin)	B1 B2	Market Size	Geographic Location
Consumer (Low margin)	C1 C2	Market Size	Geographic Location/ Low Labour Costs
Chemicals	D1 D2	Market Size	Factor Availability
High-Technology	E1	Market Size	External Funding Customer Service

Figure 6.4

6.1.6 Focus of the Firm

A dichotomy can be seen between those firms, whose primary intention is to serve the Ukrainian market, and those who are mainly concerned with developing of relationships in their home, or a third party market. This division is shown in Figure 6.5.

Note that Chemicals and Computing have been placed between the home and host market focus. Chemical firms (D1, D2, D3) had different foci for oil exploration and chemical production. Oil and gas exploration involve capitalising upon the factor advantages of Ukraine outside the market. This is essentially a home market focus. Speciality chemicals and pharmaceuticals are primarily concerned with serving the Ukraine. Therefore they are host market focused. A middle location has been used to express this combination.

Similarly, in the short-term, the computing firm felt that they might have to realise the market potential of Ukraine by gaining business with international customers or through regulatory contracts. Both are home-market focused. Longer-term, the aim was to develop business with Ukrainian customers. This would be a host market focus, so it, too, has been plotted in a middle position. Telecommunications has also been given a middle location. External funding was important in entry. This came from the Ukrainian government, however contracts from western sources were also sought.

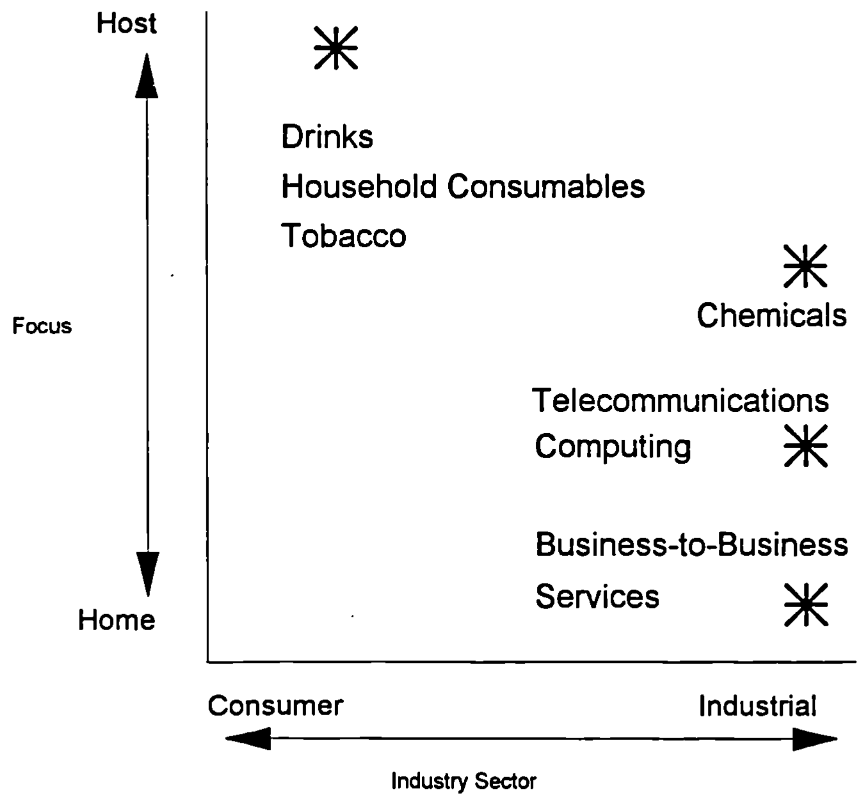


Figure 6.5

6.2 Risk and Opportunity

6.2.1 Definition of Risk

The levels of uncertainty in Ukraine pose significant risks for potential investors. Knight (1921) draws a distinction between uncertainty and risk. Uncertainty is immeasurable and may comprise hard and soft factors. Risk is the measurable consequence of uncertainty. In this study, respondents variously described risk as including:

> "the investment in people and facilities" (A2)
>
> "the risk to the good reputation of the company, if the firm withdraws from the market" (B2)
>
> "the costs of market development" (C1)
>
> "the investment in plant and infrastructure" (D3)

Thus, the broad definition of risk which has been used for this research is:

> "*all that the firm stands to lose through adverse changes in an uncertain market environment*"

6.2.2 Acceptance of Risk and Sector

It was firstly established that the level of risk involved in investment in Ukraine differs significantly between sectors. One accountancy firm expressed this as follows:

> "There is very little risk involved in investment in Ukraine. Most of our assets are portable - in people and technology. If we had to withdraw from the market, we could withdraw our people and even our portable computers. The most we stand to lose is a set of audit manuals." (A2)

Whilst the situation in the oil and petrochemical industry was seen very differently:

> "You have to understand that the risk, for us, of investment in Ukraine would be considerable. Oil refining plants are very expensive. If the climate were to worsen to the extent that we had to leave, our investment in plant and pipelines would be lost." (D3)

Moreover, in some sectors, risk is not only financial but may include detrimental effects on brand or company image. One consumer goods firm (B2) chose to overcome the problems of distribution in Ukraine by opening a high profile retail store in their strategy to enter Eastern Europe:

> "The first stage is to obtain a highly visible presence with a (...) store on what will become the "Fifth Avenue of Kiev" The contract was signed this month and our plan is for the store to act as a merchandising vehicle for B2 and its international brands. We are spreading the word about B2, what the company stands for, and the heritage of our brands. In this prestigious Kiev location, the B2 store will be elegant, but, importantly, inviting to the consumer. It will be our showpiece."(Press release by B2 December 1992).

Clearly, the risk of failure in this venture is greater than simply a financial loss. Withdrawing from such a highly publicised investment would have a significant reputational effect.

In some sectors, there are means, whereby the firm can minimise the risk of its investment, whilst in others there are none. Business-to-business service firms are often suppliers of the large western consumer and industrial goods firms who operate in the market. Thus, they incur relatively low risk, as they have a guaranteed level of business on entry. The availability of external funding, from government or regulatory agencies, may provide another means of ensuring a minimum level of business. Indeed, gaining a large contract may provide the impetus for entry into the market. Moreover, additional contracts may cause step changes in the numbers of staff, or level of investment, in the market.

However, in consumer goods or chemical industries, no such means of minimising risk are available. Moreover, the level of risk, which an investment entails, is significantly higher. The differing foci identified in Section 6.1.6 can be seen as representing different levels of risk to the firm (See Figure 6.6). The lowest level of risk is accepted by the business-to-business service firms, because of their links with industrial customers or the regulatory sector. Firms E1 and E2 have accepted a moderate level of risk as they are dealing, at least in part, in the uncertain Ukrainian market.

The high-technology firms and firms B1, D1 and C2 all entered Ukraine with low commitment modes of operation. However, these are still felt to represent a greater risk, than those accepted by the business-to-business service firms. Therefore they are placed in a middle location on acceptance of risk. The three firms which have accepted the highest levels of risk are C1, B2 and D2, which entered Ukraine with high levels of investment.

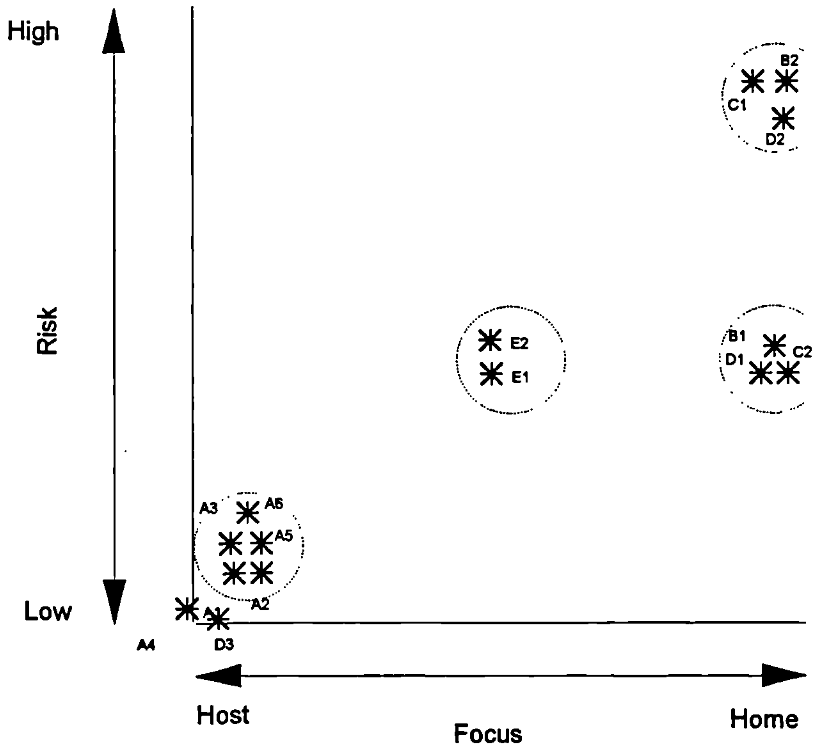


Figure 6.6

6.2.3 The Effect of Size and Degree of Internationalisation on Acceptance of Risk

Although all of the cases involve firms which could be classified as multinational corporations, there is still a considerable variation in their size, as is shown below in Figure 6.7 (See Appendix 2 for full details).

Size		Degree of Internationalisation	
Turnover		*Sales ex home Country (%)*	
	Mean Value £21,193 m		Mean Value 60%
	Range £2,624 m - £102,690 m		Range 44% - 75%
Employees		*Countries with investments*	
	*Mean Number 57,,*319		Mean Value 53
	Range 100 to 133,000		Range 7 - 121

Figure 6.7

Size

The size of the firm was not often referred to. For most firms, data were taken from secondary sources, such as company reports and handbooks. Some respondents from subsidiaries could not give size or internationalisation data. However, the size of the firm, relative to its competitors, was mentioned in association with its acceptance of risk. Size was considered to be particularly significant by firms, which were smaller than their competitors, as they saw this as a reason why their firms were less able to accept the risk of large investments.

Firm B1 stressed that it needs to be more "cautious" in the investment decisions which it makes, because its three rivals are:

> "four times as big on turnover, assets and profits. Therefore they can afford to take the risk of a longer-term investment.

A5 explained their choice of location in terms of size:

> "we deliberately entered Donetsk, rather than Kiev, when we entered Ukraine, because we knew that the Big Six would all go into Kiev"

Conversely, larger firms may feel themselves more able to gain first-mover advantage:

> "We took a risk here, and it's one C1 can afford. The question is: can we survive until Ukraine goes back up, and are we building a competitive advantage in the meantime?" Business Central Europe, February 1994

However, size, alone, does not appear to be the only influence upon perception of risk. One of the high technology firms studied explained:

> "E2 is a large company. It could have had business in Ukraine for $5 million and made a return of $15 million within the year. But it would have needed to make the investment up-front and the risks were considered to be too high. The market is just too financially unstable."

This concern with relative size supports Kutschke's view (1985) that firm-specific variables, such as size and degree of internationalisation, should be used as relative rather actual values.

Degree of Internationalisation

Definitions of the multinational corporations differ. Daniels and Radebaugh (1992) give the following definition:

> "The Multinational Enterprise, or MNE, has a world-wide approach to foreign markets and production and an integrated global philosophy encompassing both domestic and overseas operations. Because of the difficulty of ensuring whether a firm has a 'world-wide approach', narrower operational definitions emerge. For example, some might say that a firm must have production facilities in some minimum number of countries, or be of a certain size in order to qualify as an MNE." (pg. 13)

As some of the cases involve service rather than manufacturing firms, the relevant parts of this definition would seem to be those of "world-wide" approach and global philosophy.

The number of markets in which firms have investments ranges from 7 to 121. The percentage of sales outside the home market ranges from 44% to 75%. Literature suggests that highly internationalised firms will tend to make larger investments, or to enter the market via direct investment (Forsgren 1989, Johanson and Mattsson 1988). All of the firms in the study are multinational, with a minimum of seven international investments (A6). The high level of internationalisation was frequently referred to in interviews:

> "B1 is a global player in a global industry. CIS, China, Vietnam and Korea are the last "virgin" markets left for us to contest."

> "In the early '80's' there were three main places in which C1 was not yet present: India, Pakistan and the USSR."

Those firms which were present in almost all world markets tended to see this a reason why they should enter Ukraine. However, geographic coverage seems closely related to the type of industry, size of firm and to other strategic variables.

Sector	Firm	Number of East/Central European Investments
Financial Services/Law	A1	7
	A2	8
	A3	10
	A4	6*
	A5	5
	A6	4
Consumer (High-Margin)	B1	3
	B2	5
Consumer (Low-margin)	C1	1
	C2	7
Chemicals	D1	4*
	D2	3
	D3	3
High-Technology	E1	8
	E2	4

Figure 6.8 * excludes investment made after data collection

More significant, perhaps, is the level of East and Central European experience of the firms. This may allow them to generalise between similar markets (Forsgren 1989, Johanson and Vahlne 1990). The number of investments in the region are summarised in Figure 6.8 above. Note that the Czech and Slovak Republics are counted separately.

Again, there is a significant variation the number of countries, in which firms have investments. Broadly speaking, firms in business-to-business and high technology sectors where investment involves lower financial stakes and less risk tend to have invested in more markets. However, there are differences within sectors, which may relate to differences in size or strategic choices. Although A5 and A6 are smaller players and less internationalised than the other firms in the study, they have a comparable number of investments in the region.

6.2.4 Assessment of Risk

There may be some connection between the level of risk, accepted by the firm, and their process of assessing market attractiveness. Firms who followed customers, or where entry was triggered by gaining government contracts, tended to be relatively little concerned with assessing market potential. In fact, the specifics of the market were often viewed as almost incidental to the decision.

However, those firms, in the consumer goods and chemical industries, looking to penetrate the Ukrainian market took a more rigorous approach. Often, the market was "prospected" from a geographically proximate country. Firm E2 were already working in Moscow and looked at Kiev, both from there and from the UK, for two years, before making the decision to enter. The Ukrainian market was "prospected" for A3 by three staff from the Moscow office. Similarly, A2 researched the potential of opening another office in Kiev, from an existing office in Moscow.

There was general agreement that operation in Ukraine involved high risks. D1 expressed the current situation in Ukraine as "shades of grey and black". The General Manager of C1 concludes: "I have no idea what will happen in Ukraine next year." The representative of B1 describes Ukraine as "the new Wild West". A6 feel discomfort at advising new foreign arrivals on negotiating Ukraine's "legal fog":

> "[we] welcome their patronage, but privately [feel] 'caught between them and a wall'. Business Central Europe, February 1994.

In the same article, Business Central Europe cite several verdicts that Ukraine is a bad risk as an investment target. The Economic Intelligence Unit, it says, quotes:

> "6,800% annual inflation, the return of central planning and possible political violence to justify a risk rating of 100, the worst mark it gives.

Whilst, Morgan Stanley simply answers the question of whether to invest in Ukraine with "Don't Dream of It"

Even between firms aiming to penetrate the Ukrainian market, attitudes to this high level of risk vary. One of the firms (D3) uses a formal two-stage process to assess attractiveness. If the basic scientific, resource-level case is proven, then the market opportunity is assessed by balancing the level of risk against the likely returns. Return on Investment (ROI) is a measure which was referred to by a number of the firms as a means of assessing the attractiveness of an investment.

B1 stressed that they would calculate:

> "the costs of financial set-up and establishing a sales force and measure this against the potential profit on sales".

A2 said that they would use "some form of profit measurement". Whilst A3 and E1 said that they use ROI to assess the attractiveness of an investment.

However, financial measures of the risk of an investment are not always used. C1 decided to enter the Soviet Union, as early as 1988, because it was one of three geographic areas in which the firm was not yet represented. Until then it had been prevented from entering by its policy of majority control over investments, as only a 50% equity stake was allowed in Soviet joint ventures. When this restriction was relaxed, C1 entered the market in order to gain first-mover advantage over competitors. In the early years of its operation, the levels of risk of operation in the market shifted radically. At the end of 1991, the Soviet Union dissolved. C1 also split with its first Joint Venture partner. However, the long-term goal of building market share has sustained it through these difficulties.

Similarly, B2 decided to enter Ukraine, whose situation they liken to that of South America 40 to 50 years ago, with a number of high profile investments. However they see this as being part of a process of "developing, testing and refining propositions for the whole region". The ultimate goal is Russia.

Interestingly, there was relatively little use of formal planning methods to assess the level of risk. A number of firms said that they had "reviewed the usual market research reports" in initial consideration of the market (A2, E1, B1). However, the typical view is that risk is high. The critical question was seen to be that of whether the opportunity is sufficient that the Ukraine is still interesting.

6.2.5 Assessment of Opportunity

The focus upon opportunity was explained by the Market Research manager of B1 as follows:

> "we know there is high risk in operating in Ukraine. Beyond the basic secondary research reports we have not explored the precise nature of this in detail. We are more concerned with the size of the opportunity. We need to know if this is large enough to justify the risk."

Similarly, E1 were attracted by the magnitude of the opportunities in East and Central Europe:

> "The rapidly changing situation in Central Europe provides new challenges - and opportunities - for E1. Gone are the restrictions on what can be exported, who can buy goods, and who can sell. No longer is the western [technology] restricted to a few, centrally controlled, organisations. The market is opening up and quickly." E1 Company Newsletter (1991).

B1 described the process of assessing market attractiveness as follows:

> "On liberalisation, Eastern Europe was a 'blank sheet' We even had to get maps to find out geographic location and population sizes (...) Basic desk research from the DTI, EIU and other published sources showed that the market size of Ukraine was attractive. Desk research from the FT and DTI helped to establish the nature of the industry in the market. How many factories and what the output figures were. Assessing the market potential was much more important than the level of risk. We know that the risks are high, the question is whether there is sufficient of an opportunity to justify the level of risk?"

Secondary data was useful, but not produced specifically for the purpose in question. Data such as the 1989 census of the Soviet Union was used to provide demographic background. At the next stage, primary surveying was carried out by the Marketing Information Centre in Moscow. Sampling was not proportionate, but based on the main centres of population. The question related to the brands used, preferences and loyalty. Group discussions were used. The key question related to price of the Western brand vis à vis local alternatives and the percentage of the market which was likely to buy the brand. In fact, local brands were found to be selling for less than B1's cost of production.

According to C1, primary data collection was complicated by cultural factors. The firm encountered two main problems during primary data collection:

> "Firstly, Soviet people are not accustomed to such market research and housewives were quite suspicious and reluctant to take place in such research. A gentle approach, the appeal of a cup of tea and a few biscuits eventually allowed researchers to convince enough housewives to carry out 8 group discussions. A second problem was the availability of a good, Russian-speaking discussion leader, because of the lack of specialists in marketing research. Someone had to be trained, in the field, by C1 staff."

C2 used questionnaires and focus groups to gain an understanding of the preferences of consumers in Ukraine. However, their manager believes that the market cannot be studied "scientifically". There is such a state of "flux" that regular statistics are unreliable. Understanding the psychology of human behaviour is much more important than trying to "separate the factors" constituting risk or opportunity. Indeed, she went on to conclude that this traditional form of assessing market attractiveness is neither possible, nor relevant, in the Ukrainian situation.

6.3 Level of Commitment

6.3.1 Classification of Commitment

Differences in the criteria for entry into the market and the level of risk, which this poses for the firm, were also seen to influence their level of commitment to the market. This thesis distinguishes between *investment,* which it sees as the initial financial investment required, and *commitment*, which is defined as "*the total investment which the firm has to make in facilities, training of staff and market development*". The focus, in this study, is upon commitment.

By this definition a distributor is included as the lowest level of commitment to the market, because of the training costs involved, although it does not require an equity stake. Export operations have been excluded from this study, as they do not involve commitment to the market. For practical purposes, wholly-owned manufacturing subsidiaries are also excluded. Although these are legally permissible, none of the firms in the sample had invested in this mode of operation. The range of organisational modes available in the Ukraine and the level of commitment which these involve is shown in Figure 6.9 below.

Distributor	Representative. Office	Wholly-owned Services Subsidiary	Joint Venture Manufacturing Operation	Wholly-owned Manufacturing Operation
Low	<--------------	**Commitment**	--------------->	***High***

Figure 6.9

A number of different frameworks are proposed for assessing commitment. These differ in the order of the stages. Anderson and Gatignon (1986) classify firms as to their level of control. By this framework, knowledge agreements and minority investments as one of many partners require least control. A wholly-owned subsidiary ranks highest. Johanson and Vahlne (1977) classify modes by commitment, rather than control. Export ranks lowest, knowledge agreements occupy a middle ranking and foreign direct investment requires highest commitment. Erramilli and Rao (1990) offer the most comprehensive assessment of the level of commitment involved in modes of international operation (See Figure 6.10). They place knowledge agreements below export and distributors. However, this distinction matters little in this study, as no cases of knowledge agreement were found. In this study, the Erramilli and Rao framework is preferred, as it makes a distinction between manufacturing and service operations. Moreover, it differentiates between acquisitions and greenfield developments.

When the investment options in Ukraine are classified according to this model, the rankings are as shown in Figure 6.11. However, anomalies become apparent. Wholly-owned service subsidiaries, such as those of business-to-business service firms, are ranked higher than manufacturing joint ventures. However, the latter involve much higher commitment.

Foreign Market Entry Mode	Resources Required for Commitment	Market Specificity of Investment	Level of Involvement
1. Wholly-owned subsidiary (Greenfield)	*Very High*	*High*	*9 (highest)*
2. Wholly-owned subsidiary (Acquired)	*High*	*High*	*8*
3. Majority Joint Venture	*Moderate to High*	*High*	*7*
4. 50-50 Joint Venture	*Moderate*	*High*	*6*
5. Minority Joint Venture	*Moderate*	*High*	*5*
6. Export Subsidiary	*Moderate*	*Moderate*	*4*
7. Direct to Customer Exports	*Low to Moderate*	*Low*	*3*
8. Agent/Distributor Exports	*Low*	*Low*	*2*
9. Licensing/Franchising	*Very Low*	*Very Low*	*1 (Lowest)*

Figure 6.10

Distrib. Agent	Rep. Office	Wholly-owned Sales/Marketing Subsidiary (Greenfield)	Joint Venture Manufacturing Operation (Acquisition)	Wholly-owned Manufacturing Operation (Acquisition)
2	4	9	7	8*
Low	<——————	*Level of Involvement*	——————>	*High*

Figure 6.11 * Erramilli and Rao scale

Therefore, a revised scale of commitment in Ukraine is developed, based upon the Erramilli and Rao model. A distinction is drawn between service and manufacturing subsidiaries. The law and financial service firms in this study require far smaller financial investments and, consequently, less commitment (See Figure 6.16). One exception is the retail facility of B2. This involves premises and high "reputational commitment." Therefore this, too, is designated a different category, high on the scale of commitment (See Figure 6.12).

This revised categorisation is used to map and analyse the entry decisions in this study (See Figure 6.13). It is noticeable that in some sectors, firms have opted for broadly comparable levels of commitment. Business-to-Business Service firms felt a need to be present in the market to ensure service quality, although some chose a local partner, whilst others have wholly-owned subsidiaries. However, in other sectors, firms have made very different choices.

Foreign Market Entry Mode	Resources Required for Commitment	Market Specificity of Investment	Level of Involvement
1. Majority Joint Venture Manufacturing	*Very High*	*High*	*9 (highest)*
2. Wholly-owned Retail Subsidiary	*High to Very High*	*High*	*8*
3. Wholly-owned services subsidiary	*Moderate*	*Moderate*	*6*
4. Wholly-owned subsidiary (Sales/Marketing)	*Moderate*	*Moderate*	*6*
6. Joint Venture (Services)	*Moderate*	*Moderate*	*5*
7. Joint Venture Sales/Marketing)	*Moderate*	*Moderate*	*5*
7. Representative Office	*Low to Moderate*	*Low*	*3*
8. Direct to Customer Exports	*Low*	*Low*	*2*
9. Agent/Distributor Exports	*Low*	*Low*	*1 (lowest)*

Figure 6.12

The level of commitment chosen by consumer goods firms varies, depending on whether they are still assessing the potential of the market, or have committed to it. It seems that firms in the mass market consumer goods are forced into high levels of commitment, if they wish to penetrate the market. If firms do not manufacture in the Ukraine, the cost of their production is higher than the sales price of local alternative products (B1).

Industry Sector	Firm	Type of Operation	Level of Commitment
Sector A Business-to Business Services	A1	Services (Joint Venture)	5
	A2	" "	5
	A3	Services (Wholly-owned Subsidiary)	6
	A4	No investment	0
	A5	Services	6
	A6	(Wholly-owned Subsidiary)	6
Sector B High Margin Consumer Goods	B1	Representative Office	3
	B2	Retail (Wholly-owned Subsidiary)	8
		and Majority Stake in Manufacturing JV	9
Sector C Mass Market Consumer Goods	C1	Majority Stake in Manufacturing JV	9
	C2	Sales/Marketing (Wholly-owned Subsidiary)	6
Sector D	D1	Representative Office	3
Industrial	D2	Representative Office	3
		Sales/Marketing (Majority Joint Venture)	5
	D3	No investment	0
Sector E High technology Industrial	E1	Distributor	1
	E2	Export Representative	2

Figure 6.13

Figure 6.14 shows the mean investment size required in each of the sectors.

Sector	Financial Investment required for "High Commitment" *Range*	*Mean*
Business-to-Business Services *(assumption as per computing)*		\$937,600
High-margin Consumer Goods *Tobacco/Drinks*	\$5 million - \$104 million	\$46.5 million initial plus \$74.2 million modernisation. Total \$120.7 million
Low-margin Consumer Goods *Household Products*		£35 million initial plus \$15.7 million modernisation. Total \$50.7 million Possible multiple investments
Industrial Exploration *Chemicals* Pipelines	\$40 - \$50 million \$400 - \$500 million	\$45 million \$450 million
High-technology Industrial *Computing/Telecommunications*	\$113,000 - \$2 million	\$937,600

Figure 6.14

6.3.2 Size of Ukrainian Subsidiaries

Details of the size of financial investment in Ukraine could not be gained from all firms, therefore this is not a valid basis for comparison. However, data were available as to the number of employees in each firm's Ukrainian subsidiary. This gives a further insight into the level of commitment of each of these types of subsidiary. (See Figure 6.15).

This provides only a rough approximation. However, it can clearly be seen that there is an order of magnitude of difference between the commitment of firms with manufacturing operations and those with service subsidiaries or representative offices. C1 has 330 staff, 220 of whom are in production and only 3, the General

Manager, Finance Director and Marketing Director are expatriate. However, seven of the firms have four or less employees in the market (A6, A5, B1, D1, E2 and C2). This clearly constitutes a far lesser level of commitment.

Industry Sector	Firm	Type of Operation	Number of Employees	Number of Expatriates
Sector A	A1	Services	9	1
Business-to		(Joint Venture)		
Business Services	A2	" "	15	3
	A3	Services	16	5
		(Wholly-owned Subsidiary)		
	A4	No investment	0	
	A5	Services	2	1
	A6	(Wholly-owned Subsidiary)	3	1
Sector B	B1	Representative Office	1	1
High Margin	B2	Retail	5	1
Consumer Goods		(Wholly-owned Subsidiary)		
		and Majority Stake in		
		Manufacturing JV	10	
Sector C	C1	Majority Stake in	330	3
Mass Market		Manufacturing JV		
Consumer Goods	C2	Sales/Marketing	3	0
		(Wholly-owned Subsidiary)		
Sector D	D1	Representative Office	4	2
Industrial	D2	Sales and Marketing	3	1
		(Wholly-owned subsidiary)		
		and		
		(Majority Joint Venture)	4	
	D3	No investment	0	
Sector E	E1	Distributor	4	1
High technology	E2	Representative Office	1	1
Industrial				

Figure 6.15

6.3.3 Portfolios of Investment

As shown in chapter five, the entry decisions of the multinational firms studied can best be understood as part of a broader pattern of investment by the firm (Aharoni 1966). In explaining their investment actions in Ukraine, a number of firms referred to their firm's overall portfolio of investments in the region. Firm B1 missed out on opportunities in Czech Republic and Hungary to rivals. Therefore it was keen to assess the potential of Ukraine before competitors. This would appear to fit with oligopolistic reaction theory.

Moreover, a key criteria for investment in Ukraine was its geographic location (See Section 6.1.3) as it is considered to be geographically well-placed for access to Russia and the Southern Republics. Firm C1 manufactures in Ukraine with a view to serving the whole of the former Soviet Union. Firms were making decisions on relative attractiveness of Eastern European countries, in terms of size and stability.

Often, Ukraine and the former Soviet Republics were initially served from operations in Poland, Hungary or Czech Republic. However, as the process of transition has continued, and with the break-up of the former Soviet Union, the locus of operation in East and Central Europe has moved progressively further east.

> "Using the experience gained in the Ukraine market, B2 will then expand its operations in Russia, a market three times the size with a population of three million."

Hence it appears that additional insights can be gained into investment decision-making in Ukraine by analysing the pattern of investment which the firm has in the region as a whole. The commitment of the firms, by country and in total, are show in Figure 6.16.

Case	Czech Republic	Slovak Republic	Hungary	Poland	Russia	Ukraine	Kazh.	Baltics	Bulgaria	Romania	Total
A1	6	6	6	6	6	6			6		42
A2	5	5	5	5	5	5	5				35
A3	6	6	6	6	6	6	6	6	6		54
A4	6	6	6	6	6		6		6		42
A5	6			6	6	6					24
A6			6		6	6					18
B1				9	9	3					21
B2	6		6	6	6	9					33
C1						9					9
C2	9		9	10*	15*	6					49
D1					15*	6				9	30
D2						8					8
D3											0
E1	6	6	6	6	6	1					
E2							5	6	6		

Figure 6.16 * More than one investment

From this, it can be seen that firms, which do not have high commitment to Ukraine may have high commitment to other markets in the region. Especially in sectors, where there is resource dependency, such as oil exploration, or where significant financial outlay is required, firms may invest in a hub and spoke pattern, rather than in each market (See chapter five). The system of bidding for investment targets may influence the choice of regional hub.

In business-to-business services and high-technology industrial product sectors the investment choices are fundamentally different. The lower cost of investment and shorter-term returns may make it possible to establish subsidiaries in more Eastern and Central European countries. The investments are less critical to the organisation, and have tended to be made sooner after liberalisation. Early successes may have heightened the impetus for investment in the former-Soviet states.

A worrying trend for Ukraine is that, whilst it was originally viewed as the former-Soviet state with the greatest potential for successful reform, its growing economic and political crisis may threaten its attractiveness to investors. In several cases, an investment in Russia or Republics such as Kazhakstan or Azerbaijan is now seen to be preferable (See Chapter 7)

6.4 Typologies of Investment Behaviour

6.4.1 Summary of Explanatory Variables for Entry Decisions

From the preceding analysis, the following variables can be determined as playing a role in the decision to enter Ukraine. The variables can be split into those, which have a positive influence, in that they may prompt a firm to enter, and those which have a negative effect, in that they may cause the firm to have reservations about entering.

Independent Variables	Positive/Negative Impact	Dependent Variable
Location-specific Advantages	Positive	DECISION TO ENTER UKRAINE
Environmental Stability	Negative	
Influence of Competitors	Positive	
Influence of Customers/suppliers	Positive	
Influence of other Stakeholders	Positive	

Figure 6.17

Only the influence of competitors played a role for all of the firms. Location-specific and environmental concerns were opposite sides of the coin for all of the consumer and industrial product firms. It was important to decide whether the location-specific advantages outweighed concern over the high levels of environmental uncertainty. These variables were more important for firms focusing on the Ukraine, than those building on home market relationships. However, they were less significant to business-to-business services firms.

The sector, in which the firm operates may pose a set of challenges, which influence the level of commitment which firms choose. The nature of these may mean either a positive or negative influence. Thus, firm C1 requires a minimum level of control over any operation. Business-to-business service firms were concerned to have sufficient control to ensure quality standards. However, a number of additional variables may influence level of commitment. These are:

Independent Variable	Positive/Negative Impact	Dependent Variable
Degree of Internationalisation	Positive	LEVEL OF COMMITMENT
Sector	Positive/Negative	
Size of Firm	Positive	
Environmental Conditions	Negative	
Cost and Availability of Information	Positive/Negative	

Figure 6.18

It is clear that the level of commitment, which firms choose on entry, cannot be fully explained by demographic variables, such as length of international experience or the size of firm. The degree of internationalisation may increase the likelihood that they firm will be an early entrant into an uncertain market. In some cases (C1, B2) explicit reference was made to the limited number of markets remaining, in which the firm did not have a presence. Earlier experiences in other East and Central European markets also have a direct impact on the decisions which are made. It may even be argued that the investment decisions of a multinational corporation should not be studied in isolation, but as episodes in an ongoing investment process.

The size of the firm also has partial explanatory power for its level of commitment. Being smaller than competitors may lead to lower levels of commitment. Larger firms may be more inclined to make long-term commitment. High levels of uncertainty increase risk and will tend to reduce the level of commitment.

Of those firms wishing to serve the Ukrainian market, a rough division can be made by their level of commitment. Firms who have adopted "low commitment" modes of operation have often done so to gain fuller information as to the potential of a further investment. Reliable market information is difficult to gain from outside the market. Those who have decided for "high commitment" modes of operation do so, because they see first-mover advantage as outweighing the risks. As different commitment choices can be seen within sectors, the choice appears to arise from differences in competitive strategy, rather than from differences between sectors.

Cost and availability of information may be either positive or negative. Firms, which would need high levels of investment in entering Ukraine, such as those in consumer goods or chemical industries might be deterred by the lack of reliable market information. One means of gathering this is to enter the market, via a low commitment mode of operation. However, other firms see the lack of information as an incentive to enter a joint venture agreement with a local partner, who may have better access to information.

Porter (1985) recognises that firms may adopt different competitive strategies within an industry. He identifies differentiation, cost leadership and focus as "generic strategies" . Miles and Snow (1986) distinguish between "Prospectors", who are innovators, "Analysers", who refine upon the ideas of others, and "Defenders", who are essentially followers. These different strategies are held by Miles and Snow to be associated with different environments and to be associated with different organisational forms. Thus, it is contended that "dynamic networks" are more likely to be used by firms operating in turbulent conditions, as:

"new organisational forms arise to cope with new environmental conditions".

Building upon the Miles and Snow typologies, all of the firms which are currently operating in Ukraine are "Prospectors". They are early entrants into a high-risk market. This may be because the study involves highly internationalised firms in highly internationalised industries (Johanson and Mattsson 1988). However, in this study, the explanatory variables for entry choices appear to be those of sector, criteria for entry, acceptance of risk and level of commitment. These are seen to be key variables as they seem to reveal the clearest patterns of similarity and difference. Based upon these variables, the cases can be divided into four distinct groups.

Criteria for Entry	Industry Sector	Case	Level of Commitment
Client-serving	Financial	A2	5
	Services/Law	A3	6
		A6	6
Available Market			
Skimming	High-margin	B1	3
		B2	6
Penetration	Low-margin	C1	9
		C2	6
Market Potential	Chemicals	D1	3
(Industrial)		D2	3
		D3	0
Regulatory	Financial	A1	5
Contracts	Services	A5	6
	High-Tech.	E2	1

Figure 6.19

6.4.2 Typologies of Decision-making Behaviour

A fairly consistent type of investment behaviour can be seen by those firms who enter the market to serve international customers. The difference is only in the degree of control, which firms exercise over their operation. A2 has entered a Joint Venture with two Ukrainian "sleeping partners." Whilst A3 and A6 have opted for full control over their operation, as they believe this ensured service quality. These firms are classified as "Client-followers."

Similarly, the group which focuses upon external contracts differ from those following customers, only, in that there is a different trigger for entry. This is not service quality, but winning a contract of sufficiently large size. E2, which has one export representative in the market, originally entered because of a large government contract. At the time of data collection, their representative was assessing the market potential and seeking other such contracts. A1 and A5 have invested in the market to provide support facilities for aid agency contracts. However, they have the minimum size of representation. This group are referred to as "Externally-funded."

The remaining firms were all predominantly motivated by the market potential of Ukraine. These firms come from high and low margin consumer goods and, also, from high and low technology industrial product sectors. The division between those which chose high and low levels of commitment runs across industry sectors, as they have a choice between high and low risk entry modes.

However, some sectors have a fuller range of investment options for capitalising upon market potential than others. Hence, a chemical firm wishing to penetrate the Ukrainian market may develop business in the Ukrainian market, or else gain business from the entry of a major western customer. Whilst, a consumer goods firm may need to manufacture in the market and to find ways of understanding the way in which the Ukrainian market works, in order to be successful.

Firms can be plotted by their level of "commitment" or total investment in the market, and by their primary focus (See Figure 6.20).

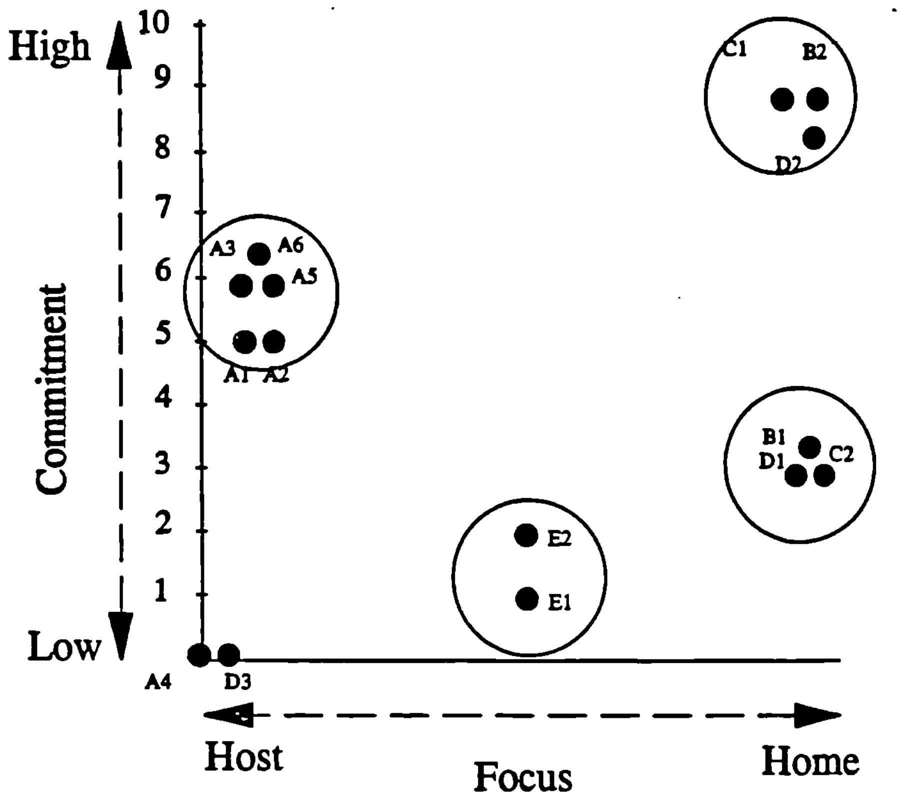


Figure 6.20

All of the firms, whose primary focus is upon building home market relationships cluster at low to moderate levels of commitment. However, firms with a host market focus can be divided into those who have chosen a low to moderate level of commitment and those who have a high level of commitment. Those, which have opted for high commitment have been designated "pioneers." Those hovering on the periphery of the market whilst further assessing market potential , are referred to as "option-takers." The latter group are nearest to the incremental process of internationalisation, suggested by Johanson and Vahlne (1977).

Thus four different groups of international investment decision-making behaviour have been identified from this case analysis:

Client-followers
Externally-funded
Option-Takers
Pioneers

These are defined below.

Client-followers

These firms (A2, A3 and A5) seem to be most influenced by their industrial customers. They are highly internationalised firms, who aim to provide a global service to these customers, who would expect comparable service quality in Ukraine to any other market. The Client-Follower enters Ukraine using the level of investment, which they consider necessary to provide this service quality. Whilst the initial impetus to enter may come from the actions of international customers, the Client-Follower may also aim to build their business in Ukraine. This may involve externally-funded contracts, additional international business, or business with local firms.

Externally-funded

The terms and conditions of aid contracts from bodies such as the EC, USAID, World Bank often specify a certain number of capabilities, which co-ordinating firms must have. Certain of these, such as provision of support services for visiting academics, may require a permanent representation in the country. The number of employees would, in the first instance, be governed by the size of the contract.

Once a representation is established, additional business may be sought either from additional contracts, or from developing business within the Ukraine.

Option-takers

These firms are influenced by the market potential of the Ukraine. This may be based on the size of the available market, its geographic location or upon factor advantages. However, either because of they are smaller than oligopolistic rivals, or more cautious in the face of uncertain conditions, these firms wish to learn more about the market. They are designated "option-takers" because they have chosen a low commitment mode of operation to establish a presence as an option on a favourable outcome of transition.

Pioneers

These firms are also influenced by the potential of Ukraine. They are highly influenced by the actions or possible actions of their competitors. The primary aim is to establish defensible market share, before competitors enter the market. This may involve buying the best investment targets, gaining exposure for brand and company names, or building the most effective distribution network. It may require buying or building a manufacturing operation in Ukraine (C1, B2) or else other forms of high commitment speculation. B2 have a high profile retail store, as well as a manufacturing Joint Venture. Indeed, two of the three pioneers studied had made multiple investments in the market. This multiple approach to investment had been adopted by cases D2 and B2.

These typologies are summarised in Figure 6.21:

Group	Primary Motivation	Reactive/ Proactive	Level of Commitment	Attitude to Risk
Pioneer	First-mover Advantage	Proactive	High	Acceptable in longer-term
Client-Follower	Customer Service	Reactive	Medium	Offset by guaranteed business
Externally-funded	Gaining Regulatory Sector Contract	Reactive	Low	Offset by regulatory funding
Option-taker	Market Potential	Proactive	Low	Minimise by incremental investment process

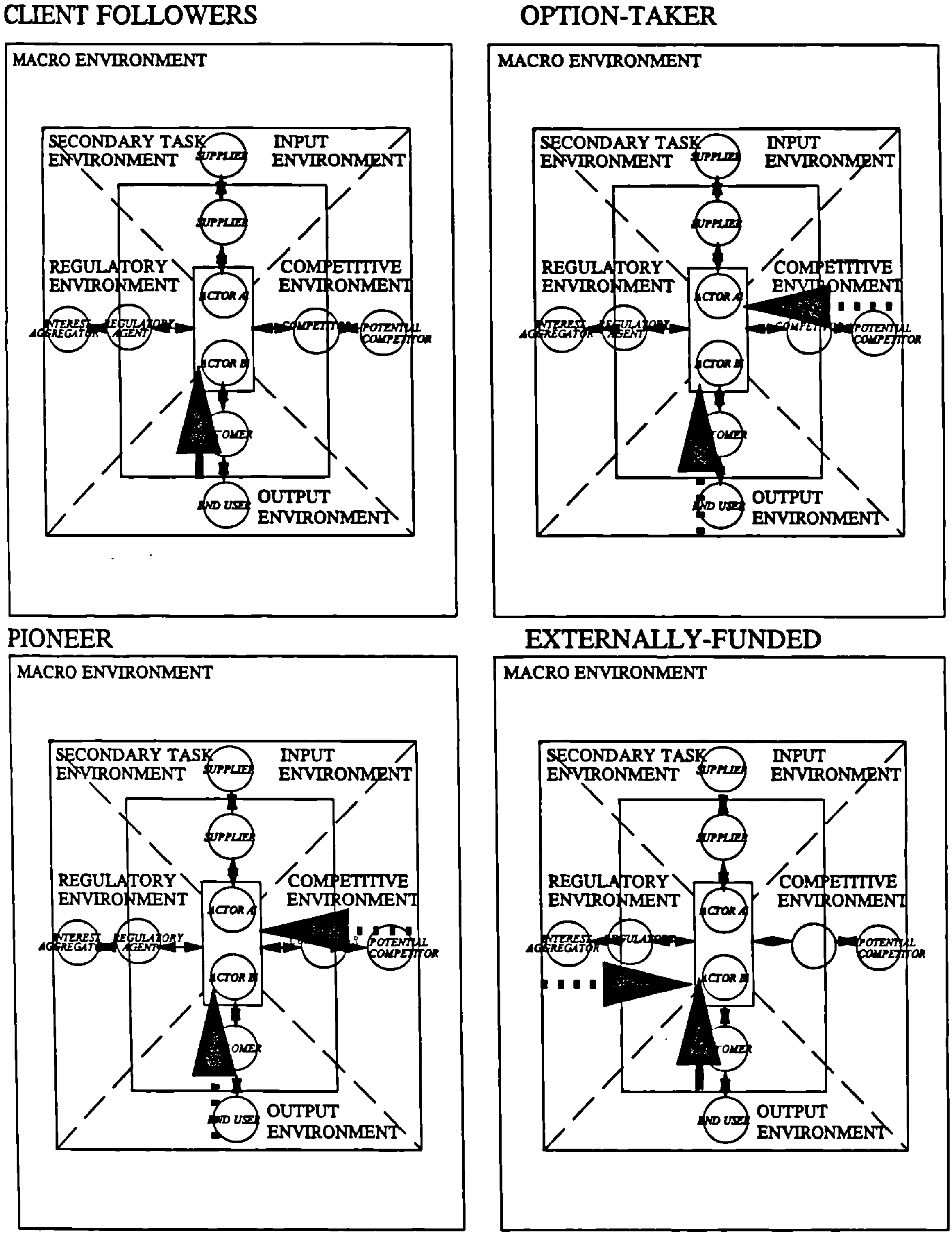
Figure 6.21

6.4.3 Analysis of the Investment Decision-making Behaviour of the Groups

The micro-environment, in which the firm operates, is split into vertical environment (inputs and outputs) and lateral environment (influence groups and competitors). The primary motivation to operate in Ukraine comes from different parts of the task environment surrounding the firm for each group. This can be mapped on Achrol, Reve and Stern's diagram of the task environment surrounding the firm (1983) (See Figure 6.22).

Client-Followers are influenced by their industrial customers (output environment). These industrial customers may be the Pioneers. The Externally-funded firms are influenced by links with funding bodies in the lateral, regulatory environment. Subsequent business is sought after the initial investment in the market. This may be via links in the regulatory environment or else with pioneers in the market. Pioneers are influenced by market potential (output environment). They are also

MAJOR INFLUENCES ON STRATEGIC INVESTMENTS IN UKRAINE



BASED ON FIG.1 "ENVIRONMENT OF MARKETING CHANNEL DYADS" ACHROL, REVE AND STERN <u>JOURNAL OF MARKETING</u> 1983

Figure 6.22

motivated by the actions of their rivals (competitive environment). Option-takers are similarly concerned about the actions of their oligopolistic rivals. However, they adopt a more cautious approach to investment.

For two of these groups, Client-Followers and Externally-funded firms, there are clear options for minimising the risk of operation in the market. This forms a platform of guaranteed return on the investment which is made. Additional business above this level is a bonus. Option-takers and Pioneers are distinguishable primarily by the differing attitudes which they have taken to the risks of operation in Ukraine. The groups can be plotted as to their level of commitment and the risk which they perceive in Ukraine as in Figure 6.23.

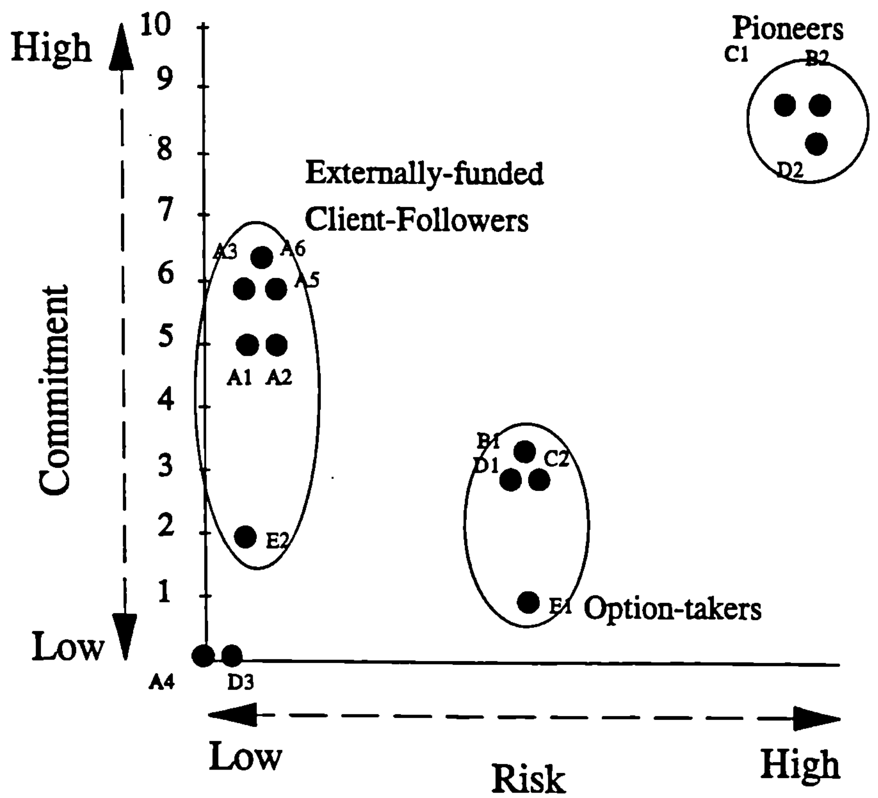


Figure 6.23

6.5 Chapter Summary

From cross-industry analysis of entry decisions, the following variables are seen to play a role in the decision by multinational firms to enter Ukraine.

Independent Variables	Positive/Negative Impact	Dependent Variable
Location-specific Advantages	Positive	DECISION TO ENTER UKRAINE
Environmental Stability	Negative	
Influence of Competitors	Positive	
Influence of Customers/suppliers	Positive	
Influence of other Stakeholders	Positive	

Analysis shows that firms make different choices as to the level of risk, which they are prepared to accept and as to the level of commitment, which is required for entry. This may be related to the industry sector of the firm. In business-to-business services and high-technology products firms might minimise the risks of market entry by gaining external funding or through relationships with existing customers. However, these options are not open to consumer goods firms. In industrial products, relationships with existing customers might be expected to offer an option. However, these are not available to the chemicals firms studied, because they are the earliest entrants into Ukraine.

Even within industry sectors, firms make different risk and commitment choices. Within the consumer goods and chemicals sectors, firms are divided between those which opt for high and low commitment modes of operation. Three firms (D2, B2 and C1) have made high commitment decisions, whilst four others have opted for low commitment (D1, D3, B1 and C2).

The influences upon the level of commitment which is chosen. These can be summarised as:

Independent Variable	Positive/Negative	Dependent Variable
Length of International Experience	Positive	LEVEL OF COMMITMENT
Sector	Positive/Negative	
Size of Firm	Positive	
Environmental Conditions	Negative	
Cost and Availability of Information	Positive/Negative	

Cost and availability of information may be either positive or negative. Firms, which would need high levels of investment in entering Ukraine, such as those in consumer goods or chemical industries might be deterred by the lack of reliable market information. One means of gathering this is to enter the market, via a low commitment mode of operation. However, other firms see the lack of information as an incentive to enter a joint venture agreement with a local partner, who may have better access to information.

Pattern-matching identifies criteria for entry, level of commitment and acceptance of risk as key explanatory variables. Difference and similarities on these dimensions, allow firms to be divided into four groups: Pioneers, Option-takers, Externally-funded and Client-followers. The key features of the entry choices of each of these groups are explored.

Chapter 7 - Expansion or Exit?

7.1 Introduction

As highlighted in the methodology section of this research, the rapidly changing market environment in Ukraine has implications for data analysis. The date on which data were collected influences its content. In July 1993, when data collection began, firms were more positive about entry and expansion in Ukraine, than later in the year, as conditions worsened. Indeed, six of the firms made an additional investment decision during the period of data collection.

Subsequent Decision

No Investment	Further Investment	No further Investment	Reduction in Investment	Withdrawal
1	2	1	1	1

Figure 7.1

During the first two phases of interviews, discussion centred on the decision to enter Ukraine and the criteria on which a further investment would be made. Despite the worsening environmental conditions, assessment of market potential still tended to be positive:

> "The market potential in the chemical industry looks good" (D1- July 1993)
>
> "It is likely that a Joint Venture agreement would be reached within 2 to 3 years" (E1- May 1993)
>
> "We will be in the lubricants market in Ukraine by January 1994." (D3 - November 1993)

However, by December 1993, a growing number of firms mentioned concern at the worsening climate. They spoke increasingly of the basis on which they would defer the decision to invest, or would even reduce their involvement in Ukraine.

> "We have had a tough time with the changes in legislation. Some of these hit us badly. Particularly the law which prohibited export of agricultural produce. There is also a problem with payments for different categories of products, and with cash flow." (D2)

> "There is so much political instability that you can sign an agreement with someone one week, who will not be there next week. Then they say that the previous agreement was invalid and ask for a bribe. Success is possible if you are prepared to pay the right people." (E2 - March 1994)

> "It is shades of grey and black at present" (D1 - March 1994)

Two other firms contemplating retraction were Pioneers, B2 and C1. The latter explained their uncertainty as follows:

> "[The General Manager of C1 is] in 'continuous discussion' with his American board over how - and whether - to soldier on with its plant in Kiev, now working at half capacity (...) The question is: can we survive until Ukraine goes back up, and are we building a competitive advantage in the meantime?"

The firms which made additional decisions came from all of the sectors studied. In two cases, they involved the decision to invest further in Ukraine. However, in four cases they involved a negative decision. The extreme differences, between the experiences of the firms in this turbulent market, raises the question of what underpins these subsequent decisions. This chapter analyses the data relating to the six additional decisions which were made. It looks for factors, which explain such differing fortunes.

Trend Analysis of Positive and Negative Press Coverage of Ukraine January 1991 - March 1994

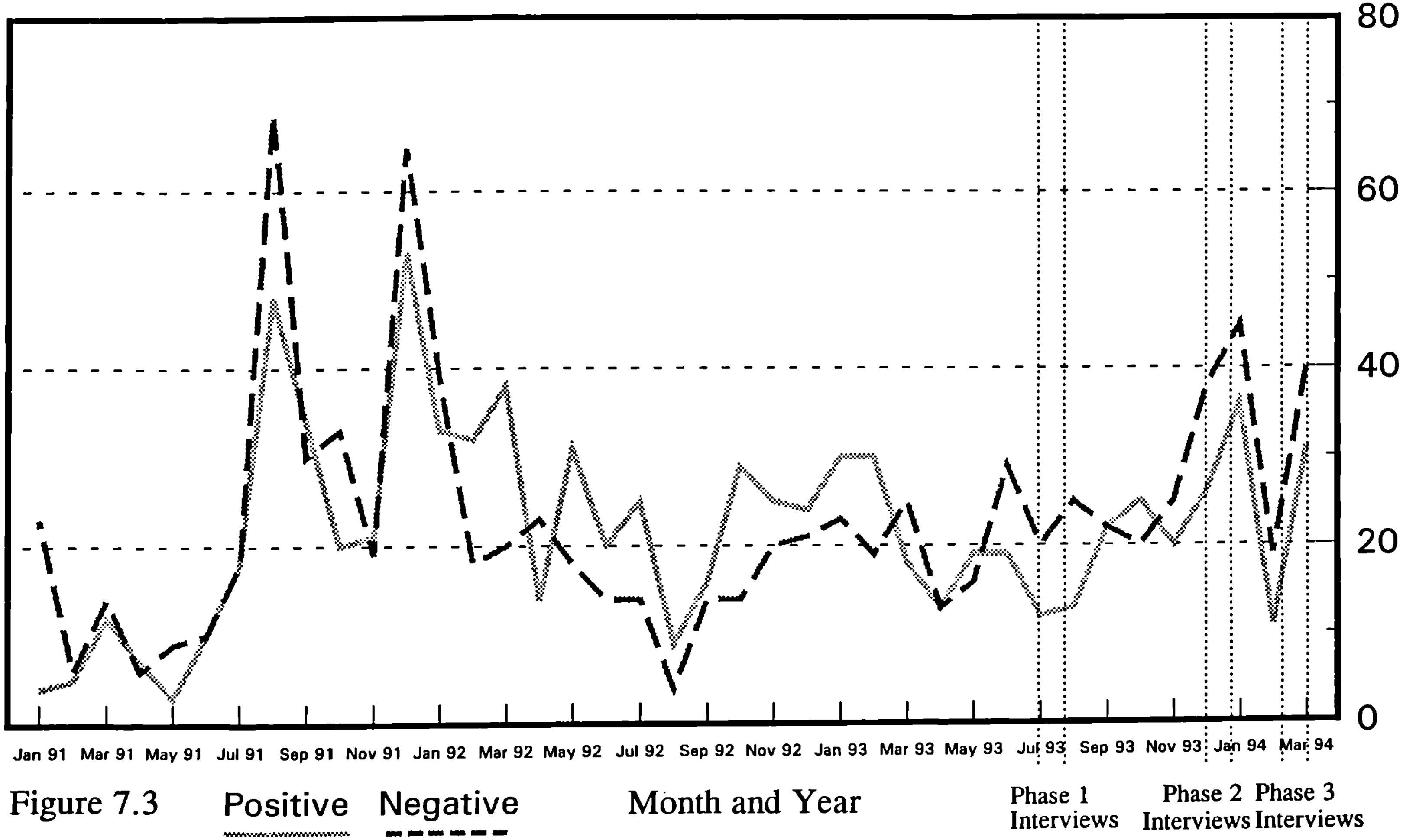


Figure 7.3

7.2 Data on Expansion and Exit Decisions

The six additional decisions are summarised in Figure 7.2. These decisions often represented a rapid reversal of previous opinions. The most extreme case was that of D3, who, in November 1993, were speaking of a definite entry into Ukraine, but, two months later, reported no imminent intention to enter. B1 also reached a negative conclusion within six months of entry.

Firm	Sector	Entry Mode	Date of Entry	Subsequent Decision	Date of Decision	Criteria
A1	Business-to Business	Joint Venture	1992	Expansion	January 1994	External Contract
A2	Business-to Business	Joint Venture	1992	Expansion	March 1994	External Contract
B1	High-margin Consumer	Representative Office	April 1993	No further Investment	November 1993	Russia more attractive
D3	Industrial Products	Possible Entry	Nov. 1993	No Entry	January 1994	Market too unstable
B2	High-margin Consumer	Joint Venture and retail	Dec. 1992	Retract to Representative Office	March 1994	Failure of ventures
E2	High-Tech. products	Export Representative	1993	Withdraw from Ukraine	March 1994	Failure of ventures

Figure 7.2

The timing of these subsequent decisions and the prevailing market conditions are shown in Figure 7.3. It is clear that the conditions had become increasingly negative towards the end of 1993. Pessimism over the prospects of successful transition to free market economy in Ukraine gained ground in the run up to the Presidential elections in March 1994. However, some firms expanded during the same time period as others decided to retract or exit. The following cross-case analysis highlights some of the variables, which may play a role in these divergent experiences.

7.2 Date of Entry into Ukraine

The date, on which the firm decided to enter the market, may be significant in understanding the entry decision it made. Figure 7.4 shows the date of entry for the thirteen firms, which invested in Ukraine.

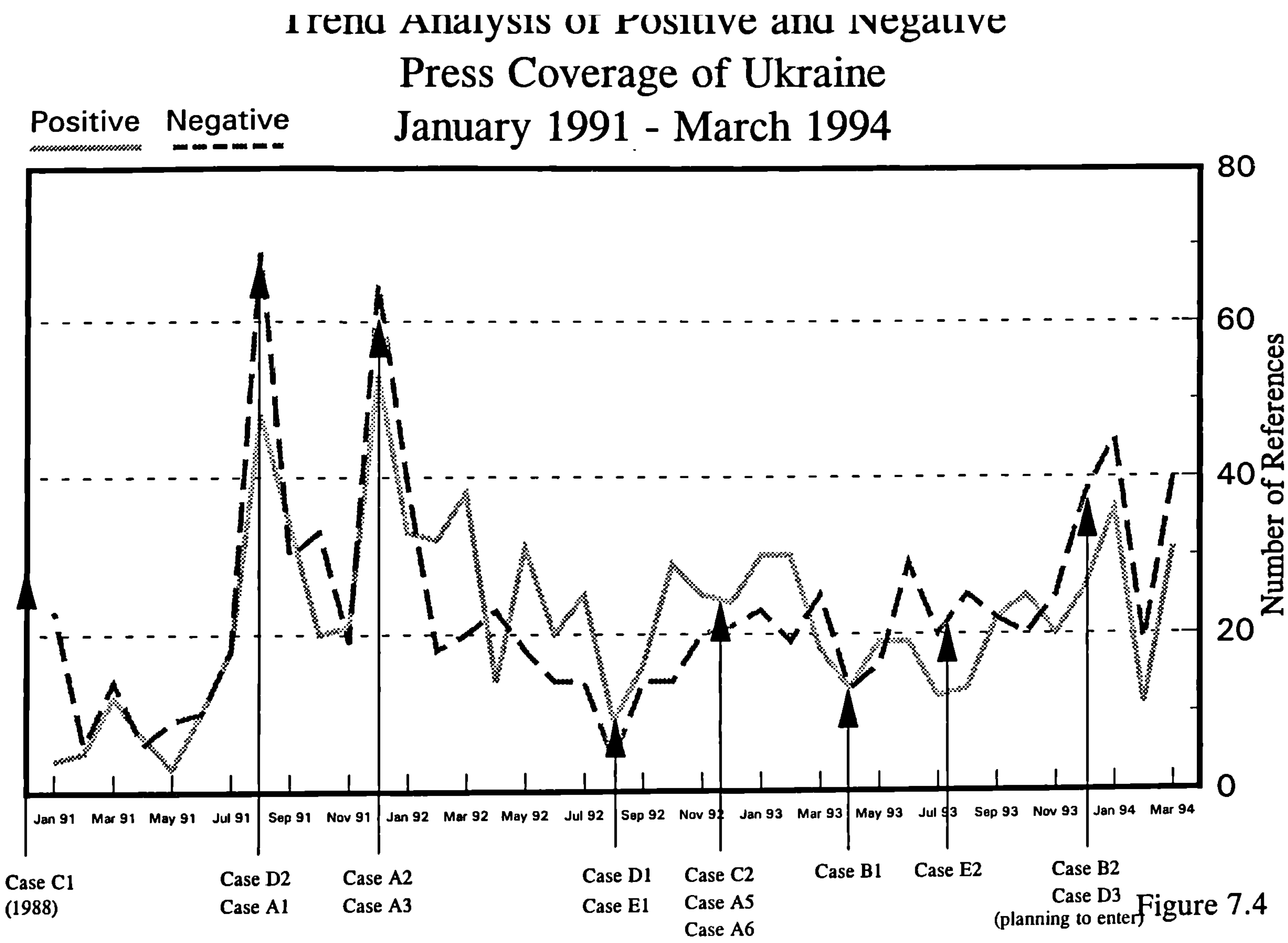
Only C1 was present in the market prior to liberalisation. However, four others entered during the process of liberalisation. On the independence of Ukraine, five of the firms were already present in Ukraine. The early entry of these firms may relate to their criteria for entry and level of commitment. Three of the entrants were either externally-funded or client-following business-to-business service firms. They were all confronting relatively low levels of risk in entering the market. Entry was prompted either by gaining a contract (A1), or else by the entry of customer, who was one of the pioneer firms (A2, A3). Entry often coincided with the high levels of publicity and optimism surrounding the market, in the period after liberalisation. Firm A2 stated:

> "The real incentive was the entry into Ukraine of a major client, with whom we have a long- standing international relationship. We actually entered the market at the end of 1991, during a PR event called the "British Days of Kiev". Our office was opened by Margaret Thatcher - we have the photos to prove it!"

The next set of firms entered Ukraine during 1992. In some instances this was the culmination of an investment process, which had been ongoing since liberalisation. Firm A6 stated:

> "The firm opened its Kiev office in 1992, when Oleg Batyuk returned to Kiev after a year of working with members of the Firm in London."

A5 had been watching its larger competitors enter the market over a period of a year, before opening its office. Whilst E2 has been present in Kiev since mid 1993. However, it had spent two years studying the market from the UK, prior to entry. B1



Trend Analysis of Positive and Negative
Press Coverage of Ukraine
January 1991 - March 1994
Positive
Negative
0
20
40
60
80
Number of References
Jan 91
Mar 91
May 91
Jul 91
Sep 91
Nov 91
Jan 92
Mar 92
May 92
Jul 92
Sep 92
Nov 92
Jan 93
Mar 93
May 93
Jul 93
Sep 93
Nov 93
Jan 94
Mar 94
Case C1
(1988)
Case D2
Case A1
Case A2
Case A3
Case D1
Case E1
Case C2
Case A5
Case A6
Case B1
Case E2
Case B2
Case D3
(planning to enter)

Figure 7.4

says its decision to enter the market was made in late 1992. The last entry decision studied, was that of B2 in December 1993. However this decision had been discussed since early 1992. B2 quote:

> "18 months of detailed analysis of the enormous potential and the tremendous problems which have to be overcome [in East and Central Europe]"

before it rolled out its investments, in September 1993 in Hungary and Czech Republic, and December 1993 in Ukraine. Thus, all of these entry decisions were made, or initiated, at a time when the prospects for the development of Ukraine looked favourable.

7.3 Criteria for Expansion

When data collection in Ukraine began, in July 1993, thirteen firms had already invested. One (D3) was about to enter. One other, A4 had no plans to enter the market. Of the thirteen firms who were in the market, three (B2, C1 and D2) already had high levels of commitment to the market. Ten others were present either in wholly-owned subsidiaries involving small number of staff, representative offices or via distributors. The latter firms were either consciously contemplating a higher level of investment in Ukraine (B1, C2, D1, D3 and E1) or else were receptive to the possibility. Accordingly, all could give the criteria, upon which they would invest further. These included:

> "Within a 2 to 3 year timescale, if a sufficient level of international business were available in the market, then A3 might decide to invest further. This would be decided by the partners, globally, and would involve calculation of the ROI of any such investment."

> "D1 is answerable to its shareholders. Whilst it is often approached by Ukrainian firms keen to set up a Joint Venture, any investment can only be made after a full assessment of market potential. Whilst the costs of investment will undoubtedly rise, D1 has a risk averse culture, and so would need both a

calculation of the size of investment necessary and the number and nature of potential customers before making this decision."

"Progress will be assessed on a year to year basis. Currently, the objective is largely to provide the necessary cover for the client base. This would be reassessed in the medium-term (3 - 5 years) on a profit basis." (A2)

Another respondent from the UK side of A2's operation saw this more pragmatically:

"A2 are looking for funding opportunities in the area. If a large enough contract were available, then an investment or further investment would be made in the target country."

A1 saw it as a multi-pronged question. There are different parts of the business, any of which may develop and cause a further investment to be made:

"The firm already has a Joint Venture in the externally-funded part of its operation. It also has a representative office, which aims to explore the business potential, both Western and Ukrainian for the business as a whole. Either one of these areas may develop. A further investment is most likely through the strong links with the EC and World Bank. A1 is closely involved as an advisor of these."

Whilst E1 concludes:

"Currently, we have not got enough knowledge of the market to make the decision on further investment. Clearly business opportunities exist. However there are also high levels of risk. The decision whether to expand will be made in 1994. This will require further assessment of the market opportunity. This would be in terms of size and how much investment. It is tempting to rush in. However, the investment would be assessed on its ROI. It would be expected to pay back within 2 to 3 years. The balance would be tipped either by an attractive partner, or by a government contract." (E1)

B1 said that a joint venture in manufacturing looked likely. There was a recognition that early entry would be cheaper. However the firm is a cautious 'follower'. It would need to see 'green shoots of recovery' before it made the decision to enter the market. The criteria for further investment can be summarised as follows:

Typology	Criteria for Expansion	Timescale
Client Followers	Service Provision External Funding	Medium-term
Externally-funded	Additional Contract Market Potential	Short-term Medium-term
Option-taker	Positive Assessment of Market Potential	Short-term
Pioneer	Next target expansion into Russia	Short- to Medium-term

7.4 Centre versus Periphery Influences

Eight of the cases in this study were researched both from the Ukrainian and Western side of the decision (A2, A4, A5, A6, B1, D3, E1, E2). In these cases, the decision to enter Ukraine was originally reached by Head Office in the United Kingdom or in France. Thus, it was possible to interview at least one person in Head Office, who had been involved in the investment decision, as well as a respondent in Ukraine. In two cases (A4 and D3), there was no representation in Ukraine.

The remainder of the investment decisions involve a more complex decision-making unit. In the case of C2, the decision to enter Ukraine had been initiated by the European operation, based in Frankfurt. However, the decision had to be ratified by Head Office in the United States. Again, in the case of C1, the Ukrainian subsidiary is in accountable to the European Head Office in London, although the Corporate Head Office is in the USA. However, it is of interest that, as conditions worsened the General Manager of C1 reported that he was:

> "in continuous discussion with his American Board report over how - and whether - to soldier on with its plant in Kiev" (Business Central Europe, February 1994).

Clearly, the magnitude of the decision is reflected in the level at which it must be taken in the organisation.

In the case of A1, relationships with both the Brussels and Washington subsidiaries of the firm influenced the decision to enter the market. However, the entry decision was made in London. Both A2 and A3 prospected the Ukrainian market from existing subsidiaries in Moscow. A2 had made the decision to enter Ukraine from its UK office. However, funding was only available from this source for one year. After this time, the firm had expanded such, that additional funds were required from the global management of the firm.

The export representative of firm E2 disagreed with his Head Office's view that there was insufficient potential in Ukraine to remain in the market. However, he also acknowledged that you had to be in the market to understand how it really operated: "It sounds a lot worse than it is." Similarly, the manager of D1 went to some lengths to stress that his views were his own. These might not correspond with those of Head Office:

> "They come out to visit once in a while, but understand little of the realities of operation in Ukraine."

In summary, it appears that geographically-proximate subsidiaries may influence entry into the Ukraine. They may also play a role in day to day operations. However, their sphere of influence does not extend to making strategic decisions, such as those of whether to remain or make a further investment in the market. These may be influenced by the periphery, but it appears that the centre still plays a dominant role. In two cases, the view was expressed that a better decision would be made if there were greater involvement of the Ukrainian subsidiary.

7.5 Home or Host Market Relationships

There were universal concerns over the state of economic collapse and political stalemate in Ukraine. However, some issues, which may have influenced expansion and exit decisions were sector specific. An area of concern, for those firms seeking to penetrate the Ukrainian market, was the difficulty of understanding how the market had previously operated and the nature and consequences of its current collapse. Consumer firms were especially troubled by the breakdown of the distribution system. Chemical firms were concerned at potential raw material shortages.

In chapter six, firms were divided into those which were reliant on relationships in their home or a third-party market and those which sought to develop relationships in the Ukraine. Externally-funded and Client-following firms were primarily influenced by home market relationships. Whilst Option-takers and Pioneers were concerned with building relationships in the host market of Ukraine (See Section 6.1.6). The following section looks at two cases, in which firms focusing on host market relationships encountered issues critical to their success.

7.5.1 Host Market Relationships

A recent conference presentation on the nature of the networks in the Ukraine under the Soviet system met with two comments. Firstly, that the Ukraine cannot strictly be called a market, as all exchange was centrally-controlled. By Williamson's definition

(1975), it was a hierarchy, rather than a market. Secondly, that in such a hierarchy, networks, the hybrid organisational form, could not have existed (Snehota 1994).

Under the Soviet régime, relationships were, indeed, controlled by the government. The manufacturing firm, the wholesale or retail intermediary and the final customer may have had no knowledge of each other. All transactions were instigated and mediated by the government. Mattsson (1993) describes this as "arm's length transactions between faceless buyers and sellers" (See Figure 7.6).

GOSPLAN, the State Planning Committee, managed the entire distribution system from supply of raw materials to physical transportation of final products. Producer prices were fixed by the authorities for long periods. Retail prices were kept stable, especially for staples, this being a matter of social policy. Prices were insulated from the world market by means of taxes and subsidies (IMF/World Bank/OECD/EBRD Joint Study 1990).

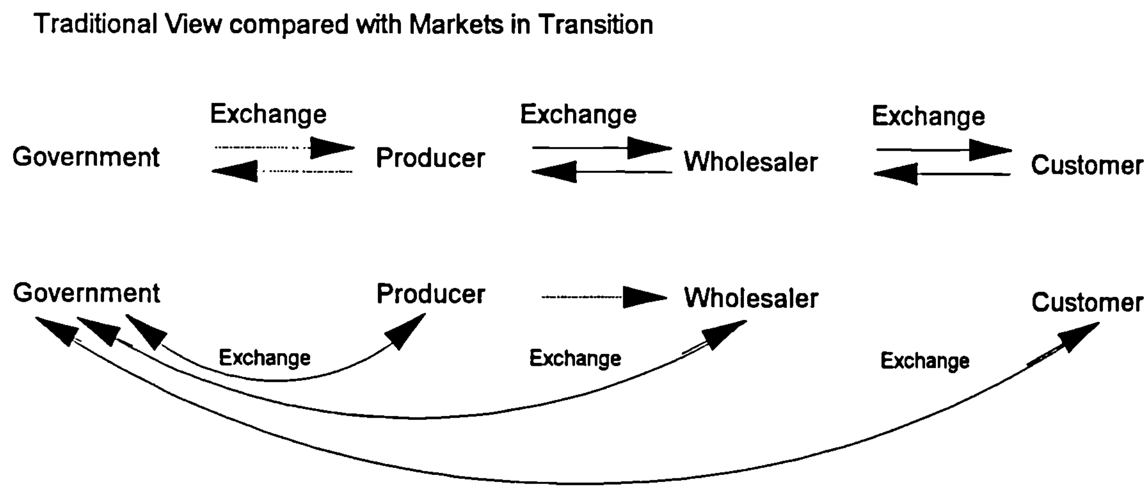


Figure 7.6

The existence of the "grey" market suggests that transactions did occur without government intervention (Salmi 1993) and, indeed, that they were nearer to free market behaviour. However, it is suggested that these were one off and motivated by opportunism (Shleifer and Vishny 1991). Transactions were most probably informal and with a different "highest bidder" on each occasion. This system did not encourage the development of on-going inter-firm exchange relationships based on trust. However, it is beyond question that, in a system where barter is commonplace, there was a strong sense of "fair exchange" between individual actors. Breger (1992) advises Western investors as follows:

> "It seems impossible to carry out the most basic business functions without enlisting the help of useful Ukrainian contacts. The old system of reciprocating favours cannot be avoided, therefore it is important to bring people on board who are bright, well-connected and resourceful. It is very difficult to go it alone."

Despite such informal transactions, the withdrawal of the government from its position of control has left a market, in which free market exchange relationships are poorly developed. Firms may not know who their customers are, as they have never dealt with them directly. The Soviet system was designed to work across national boundaries. Hence, since the creation of independent states, the individual countries have faced problems because of severance of their supply chains. A respondent from within Kiev's local government (G2) expressed this as follows:

> "When it was part of the Soviet Union, Ukraine always did as it was told to by Moscow. The infrastructure, both industrial and social was not built to meet Ukraine's needs, but those of the USSR. There is a big, rich industrial base; power and atomic stations which Ukraine does not need. Co-operation with the former USSR is still needed to gain access to those things, which Ukraine does not have. However, all connections have been severed."

Moreover, many firms have lost their guaranteed Soviet markets, for which quality and competitiveness were not prerequisites. Consequently they are facing survival crises (F1, F2, F3, I1). Analysis of two cases, one in the chemical industry and one involving consumer goods firms illustrates some of the implications of the transition process in Ukraine more fully.

7.5.2 The Case of the Chemical Industry

Ukraine's decision to become an independent state has caused significant problems for its chemical industry. The industry was located in Ukraine, as part of the Soviet Union's specialisation. Ukraine has some oil and gas, mainly in Crimea (F3). However, it has never been able to capitalise upon the oil, as it has not had the technology to drill to the necessary depth. Therefore, its large oil refining capability (65 million tonnes) and the chemical industry, which was the largest former-Soviet producer in some product categories, are reliant on oil imports from Russia and Turkmenistan.

All of the oil and 95% of the gas necessary to run the AZOT acetic acid plant were previously supplied by these states (I2). Moreover, these raw materials were supplied at significantly less than world prices. The Ukrainian Cabinet of Ministers (May 1993) indicates that natural gas was 44% of world prices. However, this rose to between 62% and 68% by September 1993, and 80% by early November 1993.

Officially, according to the central plan, a factory did not know where its products were being sold. They were simply collected in the given quantity, to a given schedule. This system operated in the chemical industry. Fediaev (I1) describes the control of the planning and registration of major types of material resources for Ukraine by the State Committee on resources of Ukraine (SCRU). The tasks of this committee included:

---

1. Determining material balances for major types of raw material and resources to meet the state demands.
2. Placing state orders to for delivery of industrial and technical goods, according to the Republic's demands.
3. Creating reserves of production and energy funds to meet the needs of the state.
4. Co-ordination of activities of organisations and enterprises and enterprises. Facilitating direct economic relationships between suppliers and users of raw materials, industrial goods and equipment.
5. In accordance with the above, the SCRU analyses the situation in supplying resources, determines demand and volumes and the main types of production to balance supply and demand.

Fediaev (I1) describes the existence of "Glavsnabs" or raw material wholesalers.

These organisations are responsible for the "direct servicing of regional wholesalers".

The aims of such organisations included:

---

1. Timely and smooth delivery of goods to regional wholesalers
2. Establishing economic relations with suppliers and customers and supporting the development of these relations
3. Finding outlets for the use of any surplus resources among regional enterprises
4. Managing the economic activities of the subordinate level of regional enterprises

---

The fulfilment of these objectives required:

---

1. Determining demand of industrial enterprises for all types of products
2. Studying the mix of goods demanded
3. Distribution of supplies among customers who have placed orders
4. Registration of suppliers and customers
5. Warehousing
6. Wholesale
7. Resource-saving

The Glasvnab responded directly to the SCRU. It co-ordinated and controlled the imports, exports and intermediate distribution of products, so that it, not the individual organisation, had most knowledge about the Ukrainian industrial system. The statistical information gathered by each Glasvnab was held centrally in Moscow. Consequently, when Ukraine became an independent state, it lost access to the main sources of information about its own industry.

Liberalisation brought major changes. The SCRU and Glasvnab withdrew from their co-ordinating rôle, without replacement. Consequently, the firm did not have sufficient information about its own suppliers and customers to continue its operation. In 1992, sales continued virtually uninterrupted, in line with the previous plan. 99% of the planned capacity was achieved. However, in the first nine months of 1993, this went down to 27.8% of planned output. This seems to have resulted from a reduction in the volume of gas and oil supplied and a loss of former Soviet markets. The supply chain, of which this factory formed a part, has been ruptured. See Figure 7.7

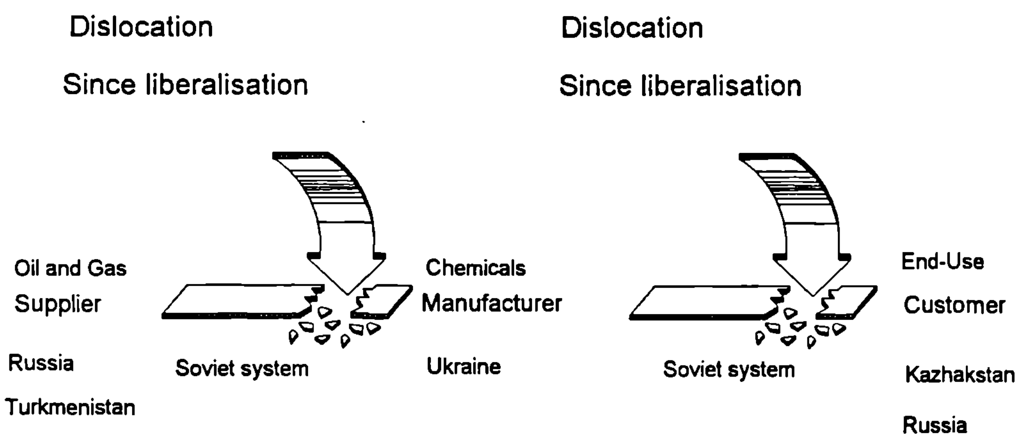


Figure 7.7

However, AZOT does not know which part of their market has disappeared. Despite this evident survival crisis, the plant gave a healthy portrayal of its market and prospects to the potential western investor. It was seeking a joint venture partner.

A student project, using Ukrainian students, was set up by the Western firm. The aim of this project was to determine whether Ukrainian students would discover any further information about the firm and its market, than had already been disclosed. The students travelled to the factory and interviewed a number of the employees. They discovered that, whilst the senior management disclaimed any further knowledge, a number of other employees were able to fill in some of the gaps. Firstly, the financial function had some billing information, which revealed the names and addresses of customers. Moreover, employees within the factory knew, from conversations with truck drivers making deliveries and collections, the approximate source of raw materials, at least in terms of country, and the location of customers.

No one within the factory was able to reveal the use to which their products were put by these customers. However the student team held face-to-face interviews with a number of customers. Some indication of the end-use of products was gained. Study of the billing list of customers provided further information. Soviet firms were often named according to their purpose, for example "Chemical Reagents Plant 'SHOSTA'". Whilst admittedly an inexact process, a far fuller picture could be recreated from these "pieces of jigsaw puzzle" than had originally seemed possible.

7.5.3 The Case of the Household Goods Market

On entry into the Ukraine in 1988, firm C1 found that the prospects seemed excellent. They sold all that they could produce "without any marketing effort." At this stage they were still using the state -controlled distribution system. In the case of household products, this comprised both warehouses "baza" and retail shops "gastronom". The central control of this system had a number of implications. Firstly, gastronom were only allowed to stock certain items, and the prices of these were fixed by government. Every gastronom looks similar. Managers had no discretion to display or promote particular products. Secondly, the mark-up of 25% from the whole chain, from producer to retail price, was fixed centrally.

This system continued to operate, after the break-up of the Soviet Union, albeit with the addition of a growing number of privately owned "kiosks", which were not subject to such constraints. However it has gradually disintegrated:

> "Consumer demand hasn't flagged (...) The problem now is distribution. Since most wholesalers are now cash-strapped, 'we can sell as much as we want, but not without advance payment.' Granting credit can produce losses within a month 'I'm just not willing to do it.' (...) When C1 started up, purchasing was one of its most important departments. Today it is sales - not the first change to test the new venture." (Business Central Europe, February 1994)

One of the major problems of the disintegration of the former system is the problem of cashflow. There are payment problems within the entire system. The banking system doesn't work. Cash transfers may take three weeks. There is an increase in the number of bad debts.

C1 stress the problem of finding alternative distribution channels to replace the state-owned system. IFC, the privatisation arm of the World Bank in Ukraine, state that relatively little privatisation has taken place. One respondent, who has worked on small and medium-scale privatisation said:

> "So far there have been 60 privatisations, mainly worker buyouts. There have been several auctions, more are coming: Zaphozhye and Ribno. Large scale privatisation is going very slowly, these are worker buyouts. 20% are on a lease. Buyouts were revoked in a December 15th decree, will probably be reversed again. Buyouts are at book value over 3 years, a very low figure however it is measured. (...) Small- and medium-sized firms are auctioned, a certain number by privatisation vouchers. These are non transferable privatisation vouchers (55 000 coupons at June 4th 1993) There are rumours that these will become transferable." (J7)

The consensus is that the privatisation process will be protracted. One local government deputy stressed:

> "The way ahead is to change the form of property ownership. Privatisation of flats, shops and state enterprises. There is no privatisation yet. The process has stopped. We have done some: shops, firms such as catering outlets and cafés." (G2)

Meanwhile, western consumer firms must find ways of overcoming the breakdown of the distribution system in order to survive. The "booming network of private street shops is an insufficient solution. *The General manager of C1 says:*

> "there are too many intermediaries selling a small amount each. And the distribution margin is too high. It would make the selling price too expensive. At present there are a lot of intermediaries taking their commission just for arranging the deal between a seller and a buyer, without any added value in terms of distribution."

He concludes:

> "There was a time when we thought Ukraine was the country with the best prospects in the Soviet Union. [Now] our arguments to the Board of Directors are much more subjective. I have no idea what will happen in Ukraine next year..." Business Central Europe, February 1994.

Even overcoming the distribution problems by vertical integration is problematic. Firm B2, who opted for the retail solution, in the hope of attracting customers to their visible Kiev store have found high levels of interest. However, sales are still disappointingly low.

7.5.4 Home Market Relationships

The levels of uncertainty faced by those firms, which are developing their existing relationships are considerably lower. Whilst the Ukrainian market still presents problems, the firms who are not reliant on linking into Ukrainian networks operate on the periphery of the market. Firms reported strong feelings of alienation. Psychic distance is high. As a result of difficulties in understanding the way Ukraine works, some respondents felt that there was an increased sense of needing to "pull together" as an expatriate community. This has not yet happened:

> "As yet there is no ex-pat community. There is the start of some social activity. There are relatively few Western hotels, and some of the business people who live there long-term have got to know each other. There is a fortnightly drink at the British embassy, which tends to be a meeting point. However there are no swimming pools or tennis clubs. The first 'Western' apartment complex has just been completed." (D1)

However, the Western business community has begun to develop. Beyond social linkages, business contacts have developed. Client-Following firms, often followed Pioneers into the market. They are a major source of information for these firms and also for the Option-takers, who have entered the market more recently (See Section 7.1). Firm B1 said that a major source of information was its financial advisor (A2). Several of the law firms have high profile positions as advisors on the contradictory legal environment. A6 are often approached by potential investors, looking to make sense of the confusion. It is common practice for business-to-business services firms who are in the market, to provide a more basic bulletins on the legal system than might be the case in a more certain environment. Three business-to-business firms interviewed provide either risk indicators, brochures on privatisation or legal surveys.

Moreover, the firms who are externally-funded invest considerable time and effort in developing their relationships in the regulatory environment. They are also providers of information. Relationships are also developing between western educators in Ukraine and the business community. Links are established by students doing market research projects for western firms, or else through recruitment of graduates. The alumni of IMI-Kiev now provide a vital link between the institution and western firms.

7.6 Explanatory Variables for Decisions to Expand or Exit

So why have the fortunes of the firms studied diverged so much during the period of data collection? The market environment has deteriorated for all firms, yet some seem to be prospering, whilst others stand still or retract from the market.

7.6.1 Reasons for Negative Decisions

The three firms who had made negative investment decisions gave the following reasons.

> "At present the market potential is overridden by the level of risk. There is an implosion of the economy; particular problems are inflation and the outcome of the forthcoming elections (March 1994)" (D3 - March 1994)

> "Any investment in the market would need to be upfront. However, Ukraine suffers from the worst of capitalism. Its ministers are self-interested. Bribes are asked for. There is market potential, but this is longer term. E2 considers the risks too high. The market is too financially unstable." (E2 - March 1994)

> "Market research of the size of the market opportunity showed the available market to be smaller than expected. Although (B1's) products were seen to be high status, research showed occasional trading up from local brands, rather than frequent purchase. Consumers do not have disposable income. At present the size of the opportunity is seen to be insufficient to justify the levels of risk involved." (B1 December 1993)

The reasons given relate largely to environmental conditions. Yet these are faced by all of the firms. Thus, other variables must play a role.

7.6.2 Sector

The two firms who invested further, or expanded during the period of data collection were both financial services firms. Thus, sector may be significant. However, the negative decisions can be less easily explained by sectoral differences. They involve firms in either consumer (B1) or industrial product markets (E2, D3). The industrial firms are in both high and low technology industries.

Case	Sector	Previous Mode of Operation	Entry Date	Further Decision	Date of Decision	Criteria
A1	Business-to Business	Joint Venture	1992	Expansion	January 1994	External Contract
A2	Business-to Business	Joint Venture	1992	Expansion	March 1994	External Contract

Figure 7.8

7.6.3 Date of Entry

The three firms making negative decisions are all firms whose initial interest in the market was relatively late. Figure 7.9 shows the date of entry of these firms. Whilst the initial interest may have been earlier, entry in three cases was in 1993. In mid 1993, environmental conditions began to worsen dramatically. Firms, who were assessing market potential for a further expansion at that time, were less likely to reach a positive outcome, than firms doing so a year earlier.

Case	Sector	Previous Mode of Operation	Entry Date	Further Decision	Date of Decision	Criteria
B1	High-margin Consumer	Representative. Office	April 1993	No further Investment	November 1993	Russia more attractive
D3	Industrial Products	Possible Entry	Nov. 1993	No Entry	January 1994	Market too unstable
B2	High-margin Consumer	Joint Venture and retail	Dec. 1992	Retract to Representative Office	March 1994	Failure of ventures
E2	High-Tech. products	Export Representative	1993	Withdraw from Ukraine	March 1994	Failure of ventures

Figure 7.9

Both firms, which made positive decisions were early entrants into Ukraine.

7.6.4 Level of Commitment

Another distinguishing characteristic of the two firms, which have expanded, is that the levels of risk which they face in operating in Ukraine are relatively low. Although they have joint venture or wholly-owned subsidiaries in the market, these entail relatively little investment.

However, three of the firms who have decided against further investment, or have reduced their level of investment in the market, are those with the lowest levels of investment of all the cases. B1 has a representative office, which it will retain, despite its decision not to invest further. E2 had an export representative, who was an employee of the firm. However, they had not established a subsidiary in the market.

Whilst D3 had not yet invested in the market at all. Level of commitment may be significant, to the extent that it is easier to withdraw from a low level of commitment. The firms who have withdrawn all had low levels of commitment to the market. However, remaining in the market, and achieving the original entry criteria, would have required the decision by B1 and D3 to make a substantial further commitment.

At the end of data collection one firm was in the process of deciding whether to retract (B2). Another, (C1) expressed uncertainty over its future. These firms have high levels of commitment in Ukraine. Their reluctance to withdraw or retract may relate to this high level of commitment. The financial and reputational stake in Ukraine is much higher for these firms. Therefore, they may be more likely to remain in the market, through worse environmental conditions, than those firms who have little to lose by withdrawal.

7.7 Ongoing Validity of Criteria for Entry

A key issue for firms in Ukraine is whether the original investment goal can still be attained, or whether it has been eroded by the environmental changes.

7.7.1 External Funding

Firms A1, A5 and E2 originally entered the market because of the possibility of contracts from the regulatory sector. The risks for firms, which have external funding, are low. Indeed, as the economic and political crisis worsens, Ukraine attracts more attention from foreign government aid agencies. Additional funding has become available and seems likely to continue. Both cases of further expansion are based upon this funding. Other firms, in sectors where such funding is available, continue to seek funding opportunities.

7.7.2 Service to International Customers

Firms A2, A3, and A5 entered the market to serve global customers. These firms are still present. They have begun to gain additional business from other foreign and local customers. The lack of reliable information and technology in the market sustains the need for western business service provision. However, few new international customers are entering Ukraine. As yet, no major customers have withdrawn. The impact of this would have a significant effect on the business-to-business services firms.

7.7.3 Geographic Location

A major objective for entry into Ukraine was its location. After liberalisation, Ukraine was widely heralded as potentially the most prosperous of the Soviet Republics, thus it was viewed as "the gateway to Russia and the former-Soviet Republics" (Manninen and Snelbecker 1993). Ukraine represented a low-risk base for forays into higher risk markets further east. Indeed, from 1989 onwards, the pattern of entry moved progressively from Central Europe towards the east.

The poor performance of Ukraine, and the relatively improved performance of countries further east, has largely negated the value of Ukraine in this rôle. Investment attention is switching from Ukraine to Russia, Kazhakstan, Turkmenistan and Azerbaijan. The tobacco firm, which decided against further investment in Ukraine, is now looking at Russia. The manager of E2, who were withdrawing from the market was en route to a new posting in Azerbaijan. B1, who had bypassed Ukraine as the site of a manufacturing joint venture gave the following reasons:

> "We were looking for a market in which to build a production facility which would supply the demands of the surrounding markets. Ukraine originally appeared to have better potential than Russia: it seemed likely to accomplish the process of transition more rapidly. However, in its current economic crisis, Ukraine may even be a worse prospect than Russia. We are now looking at the possibility of manufacturing in Russia or the Southern republics instead." (B1)

7.7.4 Market Size

Ukraine's population size makes it an attractive market for firms in both consumer and industrial markets. However, in the industrial market implosion of the economy, fuel shortages and severance of ties with former-Soviet allies have created a survival crisis. In consumer markets, low levels of disposable income raise questions as to the short-term potential of the market.

If firms are flexible they may find ways of opening up end-user markets. B2 has opened a high profile retail outlet to overcome distribution problems. C1 is selling basic formulations, which they would usually reserve for Less Developed Countries. It has introduced some new products, which are no longer sold in developed countries. Its Ukrainian joint venture partner offers valuable access to such information as exists. However, these operations are still meeting with difficulties and their future is uncertain.

Assessment of market potential has proved to be a particular problem for industrial firms. Market research into consumer preferences can, if necessary, be carried out by western agencies. However, information which has disappeared in the breakdown of the Soviet system is irrecoverable. Early entrants in this industry have struggled to piece together chains of evidence to support further investment (D1, D2).

7.7.5 Factor Advantages

Availability of raw material and low labour costs were key attractions of Ukraine. In some cases, manufacturing in the market was considered necessary in order to compete in price terms (C1, B1, C2). C1 has sold to surrounding markets to compensate for the lack of disposable income in Ukraine. However, other sectors have been less fortunate. Kravchuk banned agricultural exports. This adverse legislation destroyed the basis upon which D2 had assessed potential. Ukraine is also suffering an energy crisis. Under the Soviet régime, supplies of oil and gas were imported from neighbouring states at less than world price. However prices have risen. Gas was 44% of world price in May 1993, but had risen to 80% by early November of the same year. Moreover, a poor payment record by Ukraine has led to the restriction of the volumes of oil supplied to it by Russia.

7.8 Level of Risk

The levels of risk in the investments of the four groups, identified in chapter six, differ significantly. This relates both to level of commitment and to the focus of the firm. The risks faced by firms attempting to develop relationships in the Ukraine have been highlighted by the cases described in Section 7.2. Many of these problems seem insuperable until such time as the transition process begins in earnest. The Externally-funded firms have benefited from economic downturn. The more severe the problems in Ukraine, the more funding it has attracted. Both these firms, and the Client-followers can develop their business based on home or third-market relationships. The risks which this entails are minimal.

The expansion and exit decisions are split by typology and focus in Figure 7.10. Those firms who are expanding are doing so, primarily, when there is a guaranteed return on their investment. Both of the firms who have expanded, have done so on the basis of external funding. Although, one of the firms originally entered the market following a customer, it, too, is competing for external contracts.

Typology	Sector	Firm	Level of Commitment	Date of Entry	Focus
Externally-funded	Financial Services	A1	Low-Medium	August 1991	Home
Client-follower	"	A2	Low-Medium	December 1991	Home
Option-taker	Chemicals	D3	Low	No entry	Host
Option-taker	Consumer (High-margin)	B1	Low	April 1993	Host
Externally-funded	High-Tech	E2	Low	June 1993	Host
Pioneer	Consumer (High Margin)	B2	High	December 1993	Host

Figure 7.10

The firms experiencing difficulties are those trying to develop relationships in the Ukrainian market. Whilst high levels of risk were anticipated, most firms were awaiting indications of an upturn in the economy. Stagnation of the privatisation process and contradictory laws have resulted in short-term losses which some firms consider unacceptable.

7.9 Chapter Summary

The majority of the decisions to enter Ukraine were made when commentators were predicting a favourable economic development. Those decisions made after the market conditions worsened have tended to be negative. In the run-up to the March 1994, the prevailing pessimism led three firms who had low levels of commitment to the market to exit or to defer a decision. this was largely because Ukraine was no longer considered to be a better investment target than Russia or the Southern republics.

However, despite the worsening market conditions, successful operation in Ukraine is still possible. Those firms who serve the western business community or are reliant on funding from aid agencies or governments have been relatively little affected. It is these firms who have invested further during the period. However, the environmental conditions have been far more significant for firms who wish to penetrate the Ukrainian market. Whilst there is a large available market, the economic crisis has lessened the disposable income, such that western products are still an unaffordable luxury. Economist publication "The World in 1995" concludes gloomily:

> "There will be only limited sales opportunities for western goods, due to the continued recession, low incomes and the fact that Ukraine's trade is still heavily oriented towards Russia." The World in 1995 (1994).

Furthermore, the transition has brought its own problems. The previous system has broken down. In its aftermath, reliable market information is difficult to obtain. Distribution channels are non-existent. In March 1994, the disintegration and its consequences were clear. However, there was little sign that the transition process was moving forwards.

As a result of this increasingly negative environment, firms who had relatively low commitment to the Ukraine were beginning to exit. Those, who had high levels of commitment were also contemplating how bad conditions could become, before they too would exit. However, the stakes for the Pioneers were higher both financially and in terms of reputation.

Chapter 8 - Discussion and Conclusions

Literature proposes a broad range of variables which, it contends, influence international investment decisions. The propositions from the literature, upon which this study was based, can be summarised as shown below:

Variables	*Propositions*
a) Demographic Variables:	
Firm Size	*1. High levels of resources in the firm may reduce the significance of individual investment decisions* Forsgren 1989; Johanson and Mattsson 1988, Johanson and Vahlne 1990
Product/Service Type	*2. Modes of international investment may differ between different product or service types* Erramilli 1990; Sharma and Johanson 1987
Ownership	*3. Subsidiaries may play a significant role in international investment decisions in MNCs* Forsgren 1989; Johanson and Vahlne 1990;
	4. Investment Decisions may be routed via geographically proximate subsidiaries Forsgren 1989
International Experience	*5. Length of international experience may reduce perceived risk of an investment decision* Forsgren 1989; Johanson and Vahlne 1990
East and Central European Experience	*6. Experience of similar markets allows firms to generalise and reduces perceived risk* Forsgren 1989; Johanson and Vahlne 1990
b) Country-Specific	
Psychic Distance	*7. High levels of environmental uncertainty increase the perceived risk of investment in a country* Johanson and Vahlne 1977; Goodnow and Hansz 1972 Klein and Roth 1990

8. Traditional frameworks for assessing market attractiveness cannot explain the current pattern of investment in Ukraine
Kami 1976, Paul et al 1978, Johanson and Vahlne 1977; Egan 1993

Location-Specific Advantage

9. Factor advantages increase attractiveness of markets for investors
Dunning 1988; Rugman 1989

c) Strategic

Criteria for investment *10. The decision to enter or expand in Ukraine may be influenced by the actions of oligopolistic rivals*
Knickerbocker 1973; Buckley and Casson 1976

11. The decision to enter or expand in Ukraine may be influenced by the actions of existing customers and suppliers
Johanson and Mattsson 1988

12. The knowledge of a market, on which decisions are built, may come from the network of relationships which a firm has with other firms or with key stakeholders in the Ukraine
Johanson and Mattsson 1988

In this chapter, the findings of data analysis (chapters six and seven) are discussed in their theoretical context. This discussion is first centred around the original propositions. Then the main contributions of the thesis are synthesised in the conclusions.

8.1 The Effect of Size and International Experience upon the Internationalisation Process of Multinational Corporations

Length of international experience may reduce perceived risk of an investment decision Forsgren 1989; Johanson and Vahlne 1990

The firms, which were studied, were all multinational corporations. Johanson and Mattsson (1988) classify firms as to their degree of internationalisation and that of their industry. By this classification the cases involve firms which belong to either the "International Among Others" group, or to the "Late Starter" category. Thirteen of the firms belong to the first of these categories, as they are highly internationalised firms, in highly international industries. However, two cases in the business-to-business service sector may be "Late Starters." They operate in international industries, but are smaller and less internationalised than their competitors.

Daniels and Radebaugh (1992) define the multinational corporation as involving a

> "world-wide approach to foreign markets and production and an integrated global philosophy encompassing both domestic and overseas operations."

By this definition, all of the industries studied were highly international, though not necessarily global. Definitions of global industries tend to use geographic coverage or location of production facilities as defining variables. Hence, they may specify that firms operate in all parts of the triad (Ohmae 1990). Alternatively, firms may be said to be global if production and consumption take place in different countries.

By either of these measures, the majority of the industries studied would be classified as global. Tobacco, Drinks, Computing and Chemicals conform to both of the above definitions. However, the Household Goods industry, whilst global in its geographic coverage, may be more likely to manufacture for local consumption, in each country. Telecommunications is influenced by global technological developments and is, increasingly, characterised by transnational strategic alliances. However, it is heavily reliant on nationally-based infrastructure. Financial services and law are global in their coverage, but services cannot be split by input and output in the same way as manufacturing firms (Erramilli 1990).

For all but two of the firms, the length of international experience dated to before the Second World War. A number of the firms had operated in Eastern Europe prior to Communist rule. Forsgren (1989) suggests that firms which are highly internationalised will make larger steps in the process of internationalisation. Johanson and Mattsson (1988) also relate this to the internationalisation of the industry:

> "Both the firm and its environment are highly internationalised. A further internationalisation of the firm only means marginal changes in extension and penetration, which, on the whole, do not imply any qualitative changes in the firm."

However, two of the firms studied had decided not to enter Ukraine, despite being large multinational corporations (A4 and D3). Five others had opted for low commitment in their preliminary mode of operation (B1, E1, E2, C2, D1). A further five (A1, A2, A3, A5, A6) had opted for the minimum possible level of commitment, which allowed them to achieve their objectives in entering the market.

Only three firms, B2, C1 and D2 had made the large investments, which Forsgren would expect of a multinational corporation. Thus, degree of internationalisation may play a role in entry decisions, but it cannot explain the variation of entry choices made by the "International Among Others" firms.

High levels of resources in the firm may reduce the significance of individual investment decisions Forsgren 1989; Johanson and Vahlne 1990

As well as being highly internationalised, the firms studied had high levels of resources. Thirteen of the firms were very large multinational corporations. They ranged in turnover from £2,293 million per annum to £70, 826 million. By number of employees, the smallest of the thirteen was 12,630, and the largest 137,000. The range of employee numbers, may, in part, be explained by differences between manufacturing and services firms. In service firms, employee numbers were, on the whole, significantly lower than those of manufacturing firms, ranging from 12,630 to 59,797 compared to a range of 17,700 to 137,000 for manufacturing firms. Whilst there is a considerable overlap, the difference in mean values, 27,357 to 88, 824, shows the gap between the two.

It was found that the size of the commitments made in Ukraine are not proportionate to the size of the firm. Firm B2 had a low number of employees for a manufacturing firm. At 17,700 employees, it is smaller than two of the services firms studied. However, it has made one of the largest commitments to the market. Conversely, the largest firm, both in terms of its turnover and number of employees, D1, has taken a minimum investment in order to further assess market potential.

In some instances, however, it does appear that size and degree of internationalisation play a role. References were made by firms to their relative size and degree of internationalisation, compared to competitors. Therefore, it may be that these variables are most relevant if taken as relative, rather than actual, values (Kutschke 1985).

Accordingly, firms may feel themselves more or less able to make high levels of commitment because of their size or degree of internationalisation relative to other firms in their sector. B1 explained that it needed to be more "cautious" in its investment decisions than rivals, because they are:

> "four times as big on turnover, assets and profits. Therefore, they can afford to take the risk of a longer-term investment."

A5 stressed that it avoided entering main centres of population where their large rivals may be present:

> "we deliberately entered Donetsk, rather than Kiev, when we entered Ukraine, because we knew that the Big Six would all go into Kiev."

Conversely, C1 said that the size of its firm made it "able to take risks" especially as it is present in almost all geographic areas of the world. It was large enough to take this risk:

> "We took a risk [in Ukraine], and its one C1 can afford. The question is: can we survive until Ukraine goes back up, and are we building a competitive advantage in the meantime?" Business Central Europe, February 1994.

Those firms, with high levels of international experience or high levels of resources, may make high commitment entry decisions. Yet they do not always do so. Thus, firm-specific variables, alone, cannot explain the entry choices made in this research.

Experience of similar markets allows firms to generalise and reduces perceived risk
Forsgren 1989; Johanson and Vahlne 1990

One important distinction may be that between overall international experience and specific experience of Eastern and Central Europe. Johanson and Vahlne (1977) contend that the only type of knowledge, which allows firms to overcome psychic distance, is market specific. However, Forsgren (1989) contends that firms can generalise international experience between markets. Johanson and Vahlne (1990) acknowledge that this may be true, however, they restrict this to the ability to generalise between "similar" markets.

Whilst firms such as A6 and A5 have less international experience and are less internationalised in general, than some of their larger rivals, they have an equally strong presence in east and Central Europe. A6 specialises in East and Central Europe:

> "Partners in the firm have been active in the former-Soviet Union since the 1960's" (A6 company document)

Four of its total seven investments are in Eastern and Central European Countries. The mean number of Eastern European investments for firms in the business-to-business service category is 6.66. Proportionally, A6 is far more committed to Eastern Europe than firm A3, which has the highest number of Eastern European investments. A3 has ten investments in the area, of a total 67 investments world-wide. It is not clear whether the firms which are focused upon the region behave differently to those which greater geographic coverage. As this only applied to two cases (A5 and A6) it is difficult to postulate any conclusions.

Each of the other thirteen firms had an Eastern European Division or Practice Group, within which relevant experience could be shared. Firms suggested that the situation in Eastern Europe was so unique that even experience gained in the region prior to liberalisation was of limited value. This coincides with the views of Thomas (1994) and Egan (1993) that the challenges faced during the process of transition to free market economy are unprecedented and unparalleled. The earliest that firms could begin to gain experience of transition was in late 1989. Therefore, all have a similar length of experience in Eastern Europe.

8.2 Country-specific Influences

High levels of environmental uncertainty increase the perceived risk of investment in a country
Johanson and Vahlne 1977; Goodnow and Hansz 1972, Klein and Roth 1990

Factor advantages increase attractiveness of markets for investors
Dunning 1988; Rugman 1989

These two propositions represent the trade-off between positive and negative aspects of the Ukrainian market at present.

Because of the high levels of uncertainty in Ukraine, Johanson and Vahlne (1977) would anticipate low levels of commitment to be used in entering the market. However, two of the Pioneer firms entered the market with high commitment modes of operation (B2 and C1). Others reached high commitment decisions, after brief periods of assessing market attractiveness (A1, A2, A3, A5, A6, D2).

Cardozo (1979) suggests that firms may accept high levels of risk, if the expected return is high. A number of the firms pointed to the large available market in Ukraine (B1, B2, C1, C2), or factor advantages, such as rich agricultural soils (D2) and oil and gas (D1 and D3), as offering high potential returns upon their investment. However, these were acknowledged to be long-term goals, especially by those firms who were seeking to penetrate the Ukrainian market. Therefore, in Cardozo's terms, in the short-term risks are high, and rewards will not compensate. Rather, investments are speculative and offer only longer-term rewards.

These high levels of uncertainty were acceptable to firms, in part, because of the recognition that there are few large markets remaining, in which the firms do not operate:

> "B1 is a global player in a global industry. CIS and China, Vietnam and Korea are the last "virgin" markets left for us to contest."

> "In the early '80's' there were three main places in which C1 was not yet present: India, Pakistan and the USSR."

Despite high levels of environmental turbulence, firms were more concerned with assessment of the extent of the opportunity, than with the risks (B1, C1, D2, B2). These were acknowledged to be high. However, the issue appears to be that of the relative attractiveness of the remaining untapped markets. Thus, firms were interested in Ukraine, as having a greater potential for transformation than Russia:

> "using experience gained in the Ukrainian market, B2 will then expand its operations in Russia, a market three times the size with a population of three million."

One factor in the negative decisions seen in the later part of data collection, appears to be that this relative attractiveness has decreased. By late 1993, the Southern Republics of Kazhakstan and Azerbaijan, and in some cases Russia itself, were seen to have advanced further, in their transition than Ukraine.

8.3 Relevance of Existing Theories to Turbulent Markets

From the preceding section, it can be seen that location-specific advantages (Dunning 1988) do appear to play a role in the investment decisions made by Pioneers and Option-takers, although they are less influential in the decisions made by Client-following and Externally-funded firms. However, firms do not, necessarily, internalise capabilities as economic literature suggests (Caves 1971, Teece 1986).

It may also be because the principle uncertainty of operation in Ukraine does not arise from protection of a firm-specific asset. It arises, largely, from operation in a turbulent market, where there is a high level of psychic distance (Klein and Roth 1990). Many of the problems, which firms find in assessing market attractiveness, or predicting the likelihood or rate of transition, stem from poor availability of reliable market information.

Internalisation may provide information, gained from local employees. However, this information can be gained at less financial risk by use of a joint venture, or even a distributor. Entry into the market may be prompted by poor ability to assess market attractiveness from outside of the market. Cost of information may be less than the cost of entry into the market (Aharoni 1966). Preference for an equity stake over a contractual agreement seems to relate to issues of ensuring service quality (Erramilli 1989). In such cases, the control versus risk trade-off of Anderson and Gatignon (1986) seems applicable. Few of the firms, who wish to penetrate the Ukrainian market see benefits, at present, in wholly-owned subsidiaries.

Traditional frameworks for assessing market attractiveness cannot explain the current pattern of investment in Ukraine

Johanson and Vahlne (1977) base their assumption of incremental internationalisation upon the belief that high levels of psychic distance, comprised of cultural dissimilarity and geographic distance, may inhibit the commitment of firms to a market. Accordingly, they will adopt lower commitment modes of operation, when entering the market, and increase their commitment as they gain more knowledge of it. This knowledge must be direct and experiential (Penrose 1959) to be of value.

In section 8.1, the validity of this model for large, highly internationalised firms is challenged. Whilst the Option-takers have chosen low levels of commitment in entering Ukraine, the other categories do not fit with the model.

Johanson and Mattsson (1988) suggest that multinational corporations are concerned with a different set of issues, than less international firms. Individual investment decisions may relate to a portfolio of investments. Hence, the previous investments, which the firms have made within Eastern and Central Europe, may be significant in the entry decisions which they make in Ukraine.

Firms cited both good and bad experiences in other markets, in justification of the choices which they made in Ukraine. B1 stressed that it wished to establish a plant in Ukraine to serve Eastern and Central Europe, because it had "lost out" to large rivals in bids for privatisation targets in the Czech Republic and Hungary. D1 said that they were proceeding cautiously in the Ukraine, because of heavy losses incurred in their Hungarian subsidiary.

However, positive motivations for entry into Ukraine also resulted from the belief that this was an episode in a more extensive process. B2 had made large investments in the Czech Republic and Hungary in September 1992, Poland in early 1993, Ukraine in December 1993. They have already established a representative office in Russia, which is their ultimate goal. Investment in Ukraine was only one episode in the stream of activities in the region (Forsgren 1989):

> "This summer after considerable groundwork earlier in the year, affiliates were established in Hungary and Czechoslovakia. In population terms, these two markets are relatively small, with ten million people each (...) B2's strategy is to use these markets as a bridgehead into Central and Eastern Europe, as they are ideal for testing and refining propositions for the total region (...) Satisfied that the business [in Hungary and Czechoslovakia] is on a sound footing, B2 is preparing to move into Poland in early 1993 (...) The plan is to replicate what has been achieved in Hungary and Czechoslovakia, in a market of 30 million people (...) The next stage is to enter Ukraine, and then increase our presence in Russia (...) Using the experience gained in Ukraine, B2 will then expand its operations in Russia, a market three times the size with a population of 150 million (...) [The country manger for Russia says] The foundations which we are laying right now are critical for the long-term success of our (...) business in Central Europe." (B2 Press Release December 1992).

Similarly, C1 view their manufacturing operation in Ukraine as a way of serving the less stable, neighbouring Russian market.

Indeed, the process of international expansion in Eastern and Central Europe, by the firms studied, has been nearer to that suggested by Johanson and Mattsson (1988) for 'International Among Others' firms. They suggest that firms in this category will make internationalisation decisions, in order to strengthen and develop their "positions in global nets":

> "As extension takes place in a *globally interdependent network, the driving* forces and the obstacles to this extension are closely related to this interdependence. Models of global oligopolies fit the argument here." (p.314)

The decision to invest in Ukraine involves the process shown in Figure 8.2

Investment in Czech Republic and Hungary	→	Assessment of Potential of Next markets further East	→	Interest in Ukraine	→	Investment in Ukraine	→	Assessment of Potential of Next markets further East

Figure 8.2

The cases studied have also shown that rational planning techniques were little used by multinational firms in deciding to enter Ukraine. Little interest was expressed in exploring the precise nature of the uncertainty in the market environment. The risks of operation in Eastern Europe were known to be high. However, changes were so rapid that further precision of its composition by use of models was rarely mentioned. Only the chemical firms acknowledged the value of any risk models, and then only as one stage of the decision process. Fuller market knowledge was felt to be gained by operation in Ukraine.

8.4 The Role of Relationships

The decision to enter or expand in Ukraine may be influenced by the actions of existing customers and suppliers

This proposition refers to the network view, that firms cannot be viewed in isolation from each other (Thorelli 1986, Johanson and Mattsson 1988, Easton 1992). It is supported by the findings of this study. Three of the firms followed existing customers into the market (A2, A3, A6). Another firm, which is not currently in the Ukraine, stated that it had entered other East and Central European markets, when major customers had done so. The same criteria would be applied to Ukraine.

The criteria for entry was justified as follows::

> "to serve major customers (...) Business is centred mainly on international clients. A2 must offer a world-wide service in order to develop relationships with these clients across markets (...) we followed major clients (...) into the market with whom we have long-standing relationships in many markets" (A2)
>
> "because of a number of requests from client firms" (A3)
>
> "In 1988, the Firm assisted one of its multinational clients in the establishment of one of the first joint ventures in Ukraine, in the personal hygiene area. The Firm opened its Kiev office in 1992, when Oleg Batyuk returned to Kiev after a year of working with members of the Firm in London." (A6)

However, customer relationships are only one of the categories of relationship which are relevant to entry decisions into Ukraine.

The knowledge of a market on which decisions are built may come from the network of relationships which a firm has with other firms or with key stakeholders in the Ukraine

A further three firms entered Ukraine because of relationships, which they had with actors in the regulatory environment (E2, A1 and A5). In some cases, gaining the contract which precipitated entry into Ukraine, was only an episode in the developing relationship between the firm and the regulatory agency.

A1 explained that they were strongly motivated to enter Ukraine by their existing relationship with the EC. A1 is an advisor to the EC, on its Technical Assistance to the Commonwealth of Independent States (TACIS) programme. This connection is centred around a direct relationship between the company's Brussels subsidiary and the EC. In addition, the firm also has links with the World bank, which is actively interested in Ukraine. This relationship is via its Washington Subsidiary.

Hence, in accordance with Johanson and Mattsson's suggestion (1988):

> "since important customers or joint-venture partners in one country are also by definition international, the International Among Others is faced with opportunities for further extension or penetration in 'third countries.' Thus, a Swedish firm might increase its penetration in a South American market because of its relationship in Japan with an internationalising Japanese firm." (p. 315)

In this case the countries in question are Ukraine, Belgium, USA and UK, where the decision to enter Ukraine was instigated. However, the influence of relationships is comparable.

Moreover, many such externally-funded projects demand, by their very design, partners from a number of different countries. One EC TACIS project involved academic partners from UK and Belgium, consultants from Belgium, France, Ireland and Germany, a French co-ordinating firm and a Ukrainian recipient. The consortium has developed links between the institutions, such that different subsets of this group are involved in other EC bids. This is also referred to by Johanson and Mattson (1988) as a case of international firms in an international situation:

> "Other examples of such international interdependence are 'big projects' in which design, equipment supply, construction, ownership and operation can all be allocated to firms of different national origin, but with internationally more or less dispersed activities." (p. 315)

However, not only complementary relationships were found during this study, but also competitive relationships.

The decision to enter or expand in Ukraine may be influenced by the actions of oligopolistic rivals Knickerbocker 1973.

All of the firms studied referred to the actions of their oligopolistic rivals. They wished to gain first-mover advantage over these competitors, to gain their share of available government funding or to invest in the highest potential investment opportunities.

This preoccupation with competitors was particularly strong for those firms, which felt themselves in a position of "inferiority" vis-à-vis competitors. Hence B1 stressed that it was easier for their larger competitors to make large investments, as they are:

> "four times as large on turnover, assets and profit. therefore they can afford to take the risk of a long-term investment. We would need an investment to pay back in two to three years."

Whilst A5 claimed:

"We deliberately entered Donetsk, rather than Kiev, when we entered Ukraine, because we knew that the Big Six would all go to Kiev"

The firms, which are larger, or more internationalised, also consider the actions of their rivals, but proactively rather than defensively. C1's aim was:

"to be there before the others and develop a volume/cost competitive advantage in order to build up strong barriers to late entrants (...) to invest in the development of a strong presence now, in the hope that late entrants will have to spend more to build up a defensible position, when the market becomes attractive."

Investment in Ukraine was also described as:

"the next move in a global chess game" (C1)

and:

"jockeying for position by global rivals" (C2)

The nature of the relationships between competitors may have both positive and negative effect on the actions of firms. Porter (1990) stresses that strong domestic rivalry may provide the impetus for international expansion. In this study, it has been seen to provide an impetus for many firms to enter a new market.

Firms tend to have indirect relationships with their competitors. This may be via a shared customer, or supplier. Therefore, in this study, two firms A5 and A2 provide services to the same customer. Whilst these two firms are not direct competitors, they both provide a market information service for these customers, so may overlap. Similarly, firms A1 and A2 are both co-ordinators of contracts for the EC, therefore they have an indirect link with each other via the EC (See Figures 8.3 and 8.4)

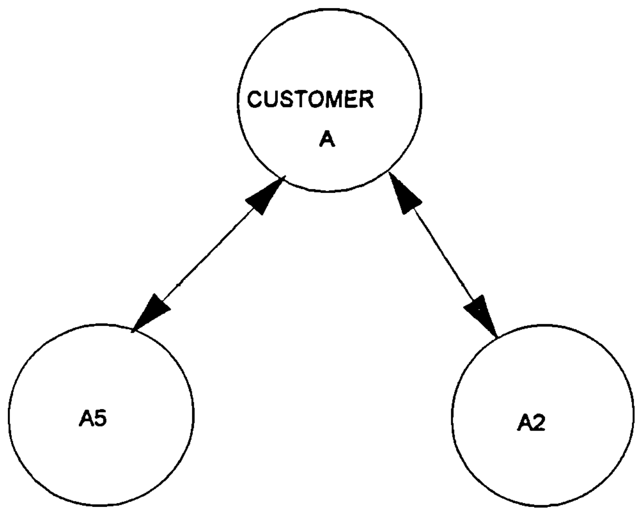


Figure 8.3

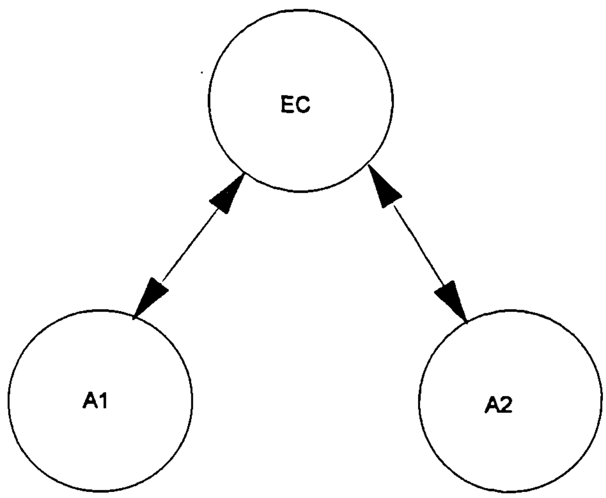


Figure 8.4

In the computer industry, one firm suggested that there were:

> "no formal links. However there is an IT community, or 'village' in which firms know what competitors are doing. Information comes from distributors, major suppliers, publications or press."

Thus the nodes in the indirect relationships in the computer industry can be either via customers, or suppliers (See Figure 8.5).

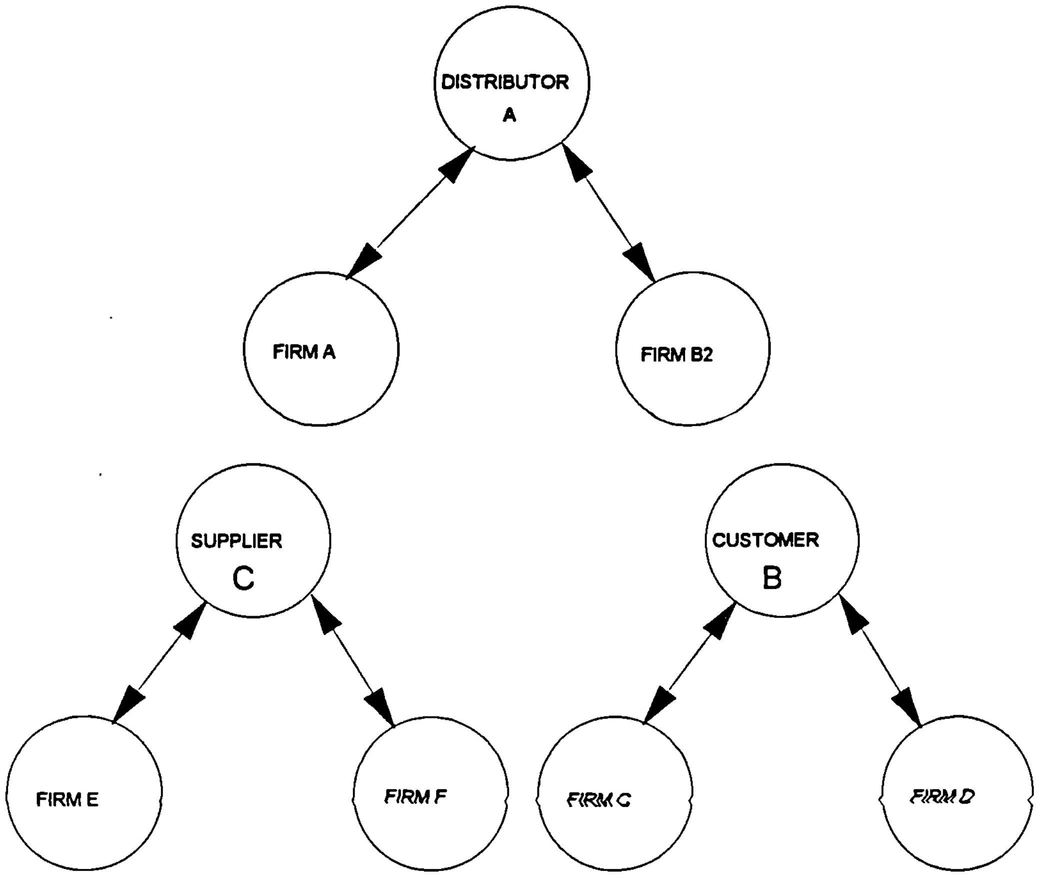


Figure 8.5

In all of these cases, the primary exchange in indirect relationships between competitors is information. However, there may also be social exchange. Competitors in Ukraine were happy to perform introductions to other respondents, in their industry, who they tended to know socially.

Knickerbocker (1973) suggests that there will be "bunching" between the date of entry into Ukraine of the leader in an industry, and the entry of following firms. Indeed, this bunching of investment activity is discernible in Eastern Europe, as a whole. Although, in each industry sector it is not always the same firm which takes the lead. Moreover, it can be seen, to some extent, in Ukraine. However, by the end of data collection, not all of the large rivals in each sector had entered Ukraine.

Indeed, the time lag between entry of the leader and the actions of the followers spanned five years in the household goods sector. Two large firms were still only present as representative offices. Two of the Big Six accountancy firms had not entered Ukraine, although four had done so three years previously. One tobacco firm decided not to enter Ukraine, whilst major rivals were making high profile investments. Moreover, firms in consumer and industrial product sectors opted for differing levels of commitment on entry into the market.

Thus, it does not appear that Knickerbocker's proposition can be empirically proven in this research. The suggestion of Buckley and Casson (1976), that, in uncertain market conditions, following firms may await the outcome of the leading firm's investment, seems more applicable. The time lag, between entry of the leader and following firms, may be explicable by ongoing uncertainty as to the success of high commitment investments. All three Pioneers, C1, B2 and D2 were reviewing their future at the end of data collection. Competitor firms, in each of these sectors, may have deferred a decision until they gave their verdicts.

8.5 Typologies of Firms

In Section 6.4, four groups of firms were identified, on the basis of level of commitment, criteria for entry and level of risk. These were:

Client-Followers
Externally-funded
Option-takers
Pioneers

The first two groups focus on relationships in their home or a third-party market. Whilst the latter two are concerned with developing business in the host market, Ukraine. This differing focus of the firms, by sector and by typology was shown in Figures 6.6 and 6.20.

The two groups, which focus on host market relationships, Client-Followers (A2, A3, A4 and A6) and Externally-funded firms (A1, A5 and E2), appear to be connected to each other. Although these two groups entered Ukraine in response to a stimulus from different sectors of the external environment, both entered for reactive reasons. Indeed, the criteria for expansion given by each of these two groups overlaps. One of the Client-followers (A2) subsequently expanded when it gained external funding. Another, A5, entered the market, when it gained a contract from the regulatory sector, but its aim is to develop a network of relationships, within its firm and within each market, to provide comprehensive information for its customers:

> "The development of their activity and a determination to take advantage of opportunities lead many companies to establish activities in foreign markets, often very distant, culturally if not geographically, from the environment with which they are familiar. Integration in such an environment involves many risks and uncertainties. A5's international network was created with a view to reducing these uncertainties and to limiting these risks in the most important markets world-wide." (A5 internal document)

Thus, it appears that these two groups are linked to each other. This link can be represented as a spectrum. Firms in business-to-business services may see international customer service as essential to their continuation. However, they must also remain profitable. Therefore, in the interim, if income can be earned from aid agency contracts, then the Client-follower will capitalised upon it. Likewise, Externally-funded firms will seek to develop a broad base of Ukrainian and international customers.

The balance between these stimuli may vary at different stages of the firm's development. The precise divide between the groups is not clear and, indeed, may vary on different occasions and within the same firm. Two respondents from A2 were at opposite ends of this continuum:

> "Business in centred mainly on international clients. A2 must offer world-wide service in order to develop relationships with these clients across markets (...) we followed major clients (...) with whom we have long-standing relationships into the market (...) Currently, the objective is to provide the necessary cover for the client base."

> "A2 are looking for funding opportunities in the area. If a large enough contract were available, then an investment, or a further investment would be made in the target country."

The two groups can be represented as follows:

Firms A3, A6 A4, A2 A1, A5, E2

Client-Followers <-->Externally-funded

Figure 8.6

The second pairing, Option-takers and Pioneers are also connected to each other. Both of these groups focus upon development of their operation in Ukraine. Therefore, they have a host market focus. The difference between the groups is only that of level of commitment to the market. Pioneers have chosen high commitment modes of entry, whilst Option-takers have made only low commitment to Ukraine.

The relationship between these two groups is complex. Option-takers can increase their level of commitment to Ukraine by a subsequent investment in the market. This could equal that of a Pioneer firm. However, they would not be level in terms of risk. The Option-taker would have the benefit of knowledge, gained in the market. Therefore, their position has been placed lower on the scale of risk, . because of this prior involvement (See Figure 8.7)

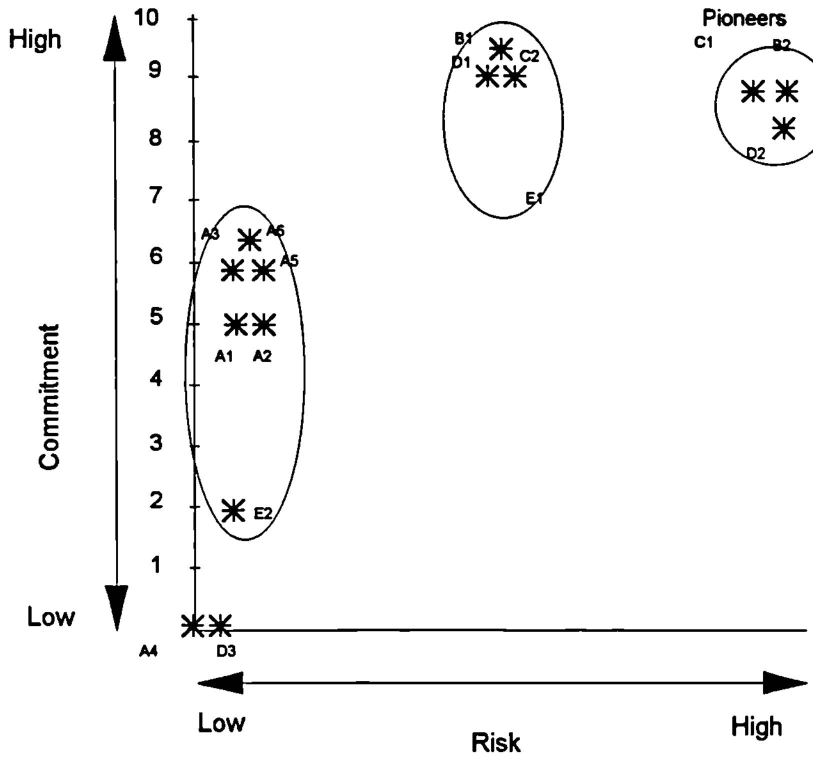


Figure 8.7

It is not clear that Option-takers could ever become Pioneers. An essential part of the entry strategy of the pioneer was the use of high commitment modes of operation, to pre-empt competitors. This first-mover advantage is complicated by the slow rate of entry into the market. In the accountancy sector, Big Six firms are still entering Ukraine. They would view the Option-takers as relatively early entrants. Indeed, by Miles and Snow's definition, all of the firms in this study would rate in their most proactive category.

However, the decision of an Option-taker to invest in a higher level of commitment in Ukraine may not involve a move towards the Pioneer category. One of the Option-takers (E1) was actively seeking external contracts, which would move it towards the Externally-funded sector. Another, D1, said that it would make a higher level of investment, if a major customer were to enter the market. This would move them towards the Client-Follower.

8.6 Home and Host Market Relationships

The knowledge of a market, on which decisions are built, may come from the network of relationships which a firm has with other firms or with key stakeholders in the Ukraine

Johanson and Mattsson (1988) suggest that firms expand internationally by a process of developing their existing "positions" within networks. This can be achieved both by marketing and by market investments (Mattsson 1985). In this research, the activities of Externally-funded firms and Client-followers, who build upon existing relationships are seen as a marketing investment. Pioneers and Option-takers, who invest in a subsidiary and seek to develop relationships in the host market are involved in market investments.

The incremental model proposed by Johanson and Vahlne (1977) suggests that any form of market investment will move the firm forwards in the process of overcoming psychic distance. Thus, direct, market-specific knowledge, gained from operation in a market will reduce the risk of investment.

If this is true in any situation, then it is certainly not so in Ukraine. The country is perceived as culturally alien by many of the western managers, who operate within it. It was referred to as "the Wild West" by one respondent (B1) and by another as "another world, which stopped forty years behind our own" (J3). However, the cultural distance between Ukraine and more advanced western economies is not only perceived from the western side. One respondent (F1) suggested to the members of the EC TACIS Marketing Team:

> "it is as though you are from another planet."

Even operation in the market for a length of time, may not be sufficient to overcome this psychic distance, or to gain the knowledge necessary to make the next investment decisions. Thus Chapter 4 describes some of the gaps in market information. These are described by one respondent as:

> "a series of inter-dependent links. If one vital piece of information is missing (...) then the chain is broken" (D1)

Another describes the "legal fog" (A6). B1 explains how contradictory the information is, which can be obtained. Whilst the manager of C1, present in Ukraine for three years describes how VAT rates have "ping-ponged from 20 to 28% and, now, for the time being, back to 0 again. He concludes:

> "I have no idea what will happen in Ukraine next year"

The nature of the market, prior to liberalisation, was substantively different from advanced western economies. Yet, firms entering the Soviet Union at this time, whilst constrained in the choices available to them, were able to operate successfully within these constraints. C1, entering Ukraine in 1990 found their products:

> "gobbled up by a market 'screaming for new products'.

Liberalisation of the former-Soviet states was heralded as the opening up of new opportunities:

> "The rapidly changing situation in Central Europe provides new challenges - and opportunities - for E1. Gone are the restrictions on what can be exported, who can buy goods, and who can sell. No longer is the Western [technology] restricted to a few, centrally-controlled, organisations. The market is opening up and quickly." (E1 Company Newsletter 1991)

However, the environmental situation is so turbulent, that uncertainty is now much higher than under the previous régime. Accordingly, many western firms are falling back on home market relationships, to obtain reliable market data.

Although some of the Option-takers have been present in Ukraine for two years, they have gained relatively little in-depth information about the country. What little they have ascertained might be invalidated by legislative changes. D2, for example, had set up a Sales and Marketing Joint Venture to assess the potential of the market for agro-chemicals in Ukraine. Kravchuk banned exports of agricultural produce. Overnight, the market potential disappeared, for the foreseeable future.

The turbulence of the situation in Ukraine calls into question the assumption of direct market-specific knowledge as a means of overcoming psychic distance. It appears that those firms with high commitment investments have come further in gaining information about Ukraine. They have encountered, at first hand, some of the critical issues of operation in the market.

As reliable data are so difficult to obtain, it may be that, in uncertain markets, the cost of information, may be to make a high commitment decision. If the firm is working at close quarters with a Joint Venture partner (A1, C1, D2), then it is more likely to gain knowledge of the market. However, the cost of this information is high. C1 say of their operation:

> "[The General Manager of C1] is in 'continuous discussion' with his American board over how - and whether - to soldier on with its plant in Kiev, now working at half capacity (...) C1's future is anyone's guess - including C1's board in the US. Despite some progress, like locals' improved business mindset, 'it's always possible that we will pull out' (...) We took a risk here, and it's one C1 can afford. the question is: can we survive until Ukraine goes back up, and are we building competitive advantage in the meantime."
> Business Central Europe, February 1994.

8.7 Acceptance of Risk

Modes of international investment may differ between different product or service types

One of the key conclusions of this study is the importance of industry sector. The specifics of the sector have a significant influence on criteria for entry, level of commitment and the type of relationships necessary for the survival of the firm.

Industrial firms, either in product or services markets, can gain business via home market relationships. However, consumer goods firms are reliant on host market consumers and channels. The level of commitment required by a firm which manufactures in the market, or adopts a high profile investment is far higher than that required for a wholly-owned subsidiary in the business-to-business sector. Moreover, whilst there are ways of minimising the risk of investment in business-to-business services, and in industrial product markets, no such option is available to consumer goods firms.

However, if firms enter Ukraine as part of a process of investment (See Figure 8.2), then the level of risk must also be viewed in comparison with other investment targets. All of the firms studied had already invested in other Central European markets (See chapter five). Their entry into Ukraine is made in the knowledge of the levels of risk, which they have accepted in the region. Moreover, the decisions in Ukraine may be influenced by knowledge of the success or failure of these previous investments.

Ukraine was either the first or second investment in the former-Soviet market for all of the firms. From 1991 to mid -1992, it was frequently referred to as the market with the greatest potential in the former-Soviet region. However, its attractiveness has declined relative to other markets in the region:

> "There was a time when we thought Ukraine was the country with the best prospects in the Soviet Union. [Now] our arguments to the board of directors are much more subjective. I have no idea what will happen in Ukraine next year" Business Central Europe, February 1994.

The Economist's forecast for 1995 makes the following assessment:

> "Czech Republic and Slovakia - The Czech Republic will remain the most stable former communist country, but tensions in the ruling coalition will surface. Radical reforms in the Czech Republic will show the first convincing results in 1995, in a second year of GDP growth. Despite Vladimir Meciar's victory, extremism should be quelled, but the political scene will still be unstable. GDP growth 1994: 0%; 1995: 1.5% (...) Russia - the political scene will be more stable after the severe upheavals of recent years, but campaigning for the 1996 presidential and parliamentary elections will intensify. Russia will come to grips with inflation and output decline will be halted by the end of the year. Relations with the former Soviet republics will improve. The thaw in relations with Ukraine, following the election of a pro-Moscow president in Kiev, will be particularly noticeable. GDP growth 1994: - 10%; 1995 - 2% (...) Ukraine - Despite a likely IMF agreement, the economy will collapse. the Kuchma government will prove as indecisive as the old Kravchuk administration. Relations with Russia may become less tense, and Ukraine may concede Sevastopol to Russia as a naval base. Nuclear disarmament will gather pace in 1995. Regional divisions will come to the fore in Ukraine. The extreme right could opt for violence. There will be only limited opportunities for western goods, due to the continued recession, low incomes and the fact that that Ukraine's trade is still heavily oriented towards Russia."

Firms, interested in the market potential of Ukraine, began, increasingly, bypass the market for healthier investment targets further East. Although it was not foreseen when data collection began, this research studied six decisions to expand in, or exit from, Ukraine. These decisions were made in the period from November 1993 to March 1994, against a backdrop of economic crisis and a stalled process of transition.

Indeed, the worsening environment in Ukraine raise the issues of outer and inner context, suggested by Pettigrew (1985a, 1985b). The outer context, the external environment in Ukraine, has worsened for all of the firm in the study. However, the extent to which this has impinged upon the inner context varies.

Those firms who are not significantly dependent upon the fortunes of Ukraine, such as Client-Followers and Externally-Funded firms, have been relatively little affected by the worsening outer context. However, for firms which are reliant on the fortunes of Ukraine the demise in the outer context is significant. There is an increased tendency to view other markets, as potentially more attractive than Ukraine. Russia, Azerbaijan and Kazhakstan, were often mentioned.

8.8 Centre-Periphery Issues

Investment Decisions may be routed via geographically proximate subsidiaries

Subsidiaries may play a significant role in international investment decisions in MNCs. Forsgren 1989; Johanson and Vahlne 1990

Some firms prospected the Ukraine from a geographically-proximate subsidiary in Moscow or Central Europe. It was common for the firm to be part of an Eastern European Practice Group (Firms A1 - A6), or else to respond to a European Head Office in Germany (C2) or Austria (B3, B4, C3).

Moreover, there was some evidence of difference in the views of Subsidiary and Head Office Managers. The representative of E2, on withdrawal from the Ukraine, suggested that he had argued to remain. Similarly the managers of D1 and A2 both claimed that there was no one at Head Office, who was worth speaking to. They know nothing of the realities of operation in Ukraine.

However, Head Office does appear to play a role, when decisions to retract or withdraw from Ukraine are concerned. The subsidiary manager of B2 claimed that he was "not authorised" to speak about the possible retraction of the firm from Ukraine. Corporate Information at the European Head Office, should be contacted instead. C1 respond to a European Head Office, but reported "continuous discussion" with the US Board of Directors over how, and whether, to continue operation in the market.

Thus, Forsgren's claim that the periphery plays an important role in the investment decisions of multinational corporations seems justified. However, some decisions can exceed the "authority" of the periphery. In such cases, decisions revert to the centre. This may relate to both positive and negative decisions. Thus, firm A2 reports that the Ukrainian investment was funded, at first, by the UK subsidiary. However, it grew so rapidly that its expansion was funded globally, by the umbrella corporation. In the two cases highlighted in the last paragraph (B2 and C1), day-to-day operations are autonomous, but negative decisions involve the Head Office.

8.9 Conclusions

It is apparent that the size and degree of internationalisation of the firms in this study enables them to make higher commitment entry decisions into Ukraine than would be expected by Johanson and Vahlne (1977). This may relate to the confidence of the managers in their international ability (Casson 1994). The levels of investment required for by high commitment modes of operation may also be considered insignificant by firms of this size. However firms did not always enter the market using high commitment modes.

One reason may be that even the "International Among Others" firms (Johanson and Mattsson 1988) vary in size and level of resources. Consequently, they may be concerned at their size relative to each other. Relative size is seen to provoke both pre-emptive and defensive reactions. Thus, firms may justify cautious entry strategies and low commitment decisions with reference to having lower levels of resources than competitors. Conversely, firms may justify high levels of commitment by ascribing this to pre-emptive strategies and the ability of the firm to take a long-term view of market potential.

The size of investment implied by high commitment varies significantly between industry sectors. The average size of initial investment ranges from $937,600 in business-to-business services and high technology and $495 million in the chemicals sector. Erramilli (1991) refers to the fact that service firms are able to take control early in market entry because of the relatively low level of investment which this involves.

In this thesis, firms for whom high commitment involves relatively low levels of financial outlay are seen to have expanded rapidly throughout the Eastern European region. Rapid expansion may also be motivated by the proactive criteria of providing high levels of service to international customers (Johanson and Mattsson 1988) or on the defensive grounds that the firm might otherwise lose business to rival firms with a presence in the market. This latter seems reminiscent of the belief of oligopolistic reaction theory (Knickerbocker 1973) that rival firms will enter a market rapidly once the lead firm has done so. In industry sectors where higher levels of investment are required, firms have focused upon a smaller number of key investments and may take low commitment modes in other markets whilst further assessing their potential.

It is clear that for all firms there is a high level of psychic distance in the decision to enter Ukraine. Klein and Roth (1990) contend that this could favour internalisation. The cost of external transactions in Ukraine is high. The country is still in the process of transition and the market, if it can be defined as such, is still subject to governmental control. Many of the difficulties of the previous system still pertain. In contrast, Johanson and Vahlne (1977) would suggest that the high levels of psychic distance would result in low commitment entry modes. However, Forsgren (1989) counters that firms with high levels of international experience may be able to draw upon lessons learned in similar markets. In most cases, Ukraine is not the first country in the region which the firm has entered, although a number of the causes of environmental uncertainty are unique to it. Casson (1994) points to the contention of globalisation literature (Porter 1980, Ohmae 1990) that as consumers' preferences are converging and as the distinguishing characteristics of each country are unique, there is little to be gained by deferring entry.

This thesis has taken an inductive approach, so as to avoid prejudging which, if any, of these theories are relevant in explaining the entry decisions of multinational corporations in turbulent markets. Indeed, the entry decisions of the firms in this study differ even within the same sector and, at first sight, appear to offer some evidence for different views. The largest variation in entry decisions is found between firms where entry involves high levels of up-front investment. These firms are primarily manufacturing firms, for whom penetration of the Ukrainian market may entail modernisation and development of infrastructure, in addition to plant and facilities.

Amongst these firms, two divergent types of entry behaviour were seen. A number of firms, described in this study as pioneers, entered Ukraine using high commitment modes. The concerns of these firms tended to relate to pre-empting competitors and gaining first-mover advantage. One influential factor in the entry behaviour of these firms may be that the cost of waiting to gain fuller information carries the danger that a rival might enter the market first. Conversely, a number of firms entered the market using minimal investment, as a means of taking an option on a positive outcome in the transition process. The number of firms in the latter category who withdrew when environmental conditions worsened may relate to their low level of commitment to the market. It may even suggest that operation on the periphery of the market is insufficient to overcome psychic distance and gain fuller market information. A number of option-takers referred to feelings of alienation.

A major objective in this thesis, which draws upon theories from a diverse range of fields, is to locate the position of its findings in the key debates. One such debate is that as to the nature and rôle of networks. Section 2.7 highlights the tension between the body of literature which views the network as an intermediate form between markets and hierarchies (Williamson 1975, Miles and Snow 1984, Thorelli 1986, Jarillo 1988) and that which sees markets as being comprised of networks (Johanson and Mattson 1987, Johanson and Mattsson 1988, Easton 1992).

The first of these schools of thought views the network as a mode of organisation a firm might use if it is the most effective or efficient. Miles and Snow (1984) favour the use of networks in turbulent markets as their dynamism is seen to offer flexibility. This would suggest the strategic use of networks by firms entering the turbulent Ukrainian market. However, Johanson and Mattsson (1987) identify fundamental differences between the "transaction cost" and the "markets as networks" approach. The major implication of the latter view is that mutual interdependence of firms means that use of assets is influenced by existing relationships. These may prompt or constrain investment decisions. This view underpins the belief that firms may make international investment decisions to develop their positions in global networks (Johanson and Mattsson 1988). The findings of this research lend support to this contention and constitute the major conclusion of the thesis.

The entry decisions of all of the firms studied were significantly influenced by existing relationships. These included direct relationships, between business-to-business services firms and their international customers and between business-to-business or high technology firms and actors in the regulatory sector. There were also indirect relationships with competitors, on the basis of which firms decided to pre-empt or react to the investments of others. For all of the groups, these relationships, which might be in the home or another international market seemed to override the specifics of the Ukrainian situation. Thus, firms entered the market after a customer, on gaining an international contract, or because it was one of the few remaining geographic areas as yet uncontested by international rivals. The decision to enter Ukraine should not therefore be studied in isolation, as it is part of an ongoing process of investments, whereby each firm is developing its position in global networks.

8.10 Chapter Summary

Firms are attracted into Ukraine, in part, by location-specific advantages (Dunning 1980). Investment activity by multinational corporations in Eastern Europe has been concentrated, because of the rapidity of liberalisation. Investment in Ukraine was favoured by its relatively good prospects for transition to market economy. It is larger than the markets of Central Europe, in which many of the firms studied already operated. In the period from 1991 to 1993, Ukraine seemed more stable than Russia.

The "bunching" of entry into the market by firms, within industry sectors, concurs with Knickerbocker's suggestions of oligopolistic reaction (1973). However, the impact of the level of risk, which the firm incurs by investment, must also be taken into account. Thus, a bunching of investments can be seen for all of the industry sectors studied. Whilst business-to-business firms had all opted for high commitment modes of operation, this involved relatively low levels of financial outlay and risk to the firm. However, in sectors such as chemicals or consumer industries, wherein the level of financial investment required was far greater, firms had opted for different levels of commitment. Therefore, the behaviour witnessed may be nearer to Buckley and Casson's suggestion (1976) that, in conditions of uncertainty, follower firms may await the outcome of the investment decision made by the leading firm, before making its own decision. This seems to fit with the Option-taker category.

Furthermore, oligopolistic reaction theory does not explain all the entry decisions. Influences were also seen to come from the regulatory sector and from the actions of industrial customers. Thus, some firms seemed more motivated by co-operative relationships, which spanned international markets.

Overall, entry into Ukraine did not appear to use rational marketing planning techniques. The validity of these has been called into question for situations of discontinuous change (Kami 1976, Paul et al 1978). The uncertain market conditions were seen to pose high levels of risk. The consumer and chemical firms studied found entry decisions justifiable, despite the levels of risk, because of the size of the opportunity (Cardozo 1979). Accepting high levels of risk was justified, in the light of longer-term gains over competition, or else, the conditions in the Ukrainian market were overshadowed by a stronger motivation. For business-to-business firms and high-technology firms, this motivation was to guarantee consistent levels of international service or to gain external funding.

This research lends support to the "markets as networks" view that investment decisions are influenced by the mutual interdependence of firms in existing relationships. Investment in Ukraine can be viewed as part of an ongoing process whereby the firm develops its position in global markets.

Chapter 9 - Future Research Directions

9.1 Limitations

This research has taken the form of an exploratory, qualitative study. It has raised some interesting issues relating to investment decisions in an uncertain market environment. The disparate levels of risk associated with the entry of multinational firms in different sectors is apparent. Moreover, explanatory variables can be identified, which explain the diverse experiences of the fifteen firms, as environmental conditions in Ukraine worsened. In-depth study has provided insights, which would not have been possible using a broader and more generalisable study, although the trade-off between depth and generalisability is acknowledged.

In the course of the research, a number of issues have been encountered, which should be accepted as limitations:

9.1.1 Contextual Changes

The rapidity, and unpredictability, of changes in the Ukrainian context had both positive and negative consequences for this research. Firstly, the study has been enriched by the additional decisions made by firms during the course of data collection. Although the constraints on the PhD process limit its extent, an element of longitudinal study has been possible in this research, which is not often possible in data collection spanning nine months. The implosion of the Ukrainian economy, in 1993, after its promising outset on the process of transition in 1991 is unparalleled, even within Eastern Europe. The rapidity of the contextual change has provided a richer understanding of the impact of the uncertain environment upon firms' investment decision-making behaviour.

Changes in attitude within, as well as between firms, can be examined to gain critical insights. Resrarch into strategic investment decisions may be criticised for failing to include firms which decided not to invest. It is difficult, however, to determine which firms should be approached, as the population is infinite. Moreover, if investment in the market is not on the "strategic agenda" then few insights can be gained. In this research, study of decisions to enter and expand in the market is combined with study of decisions not to enter, not to expand and even to exit. A total of twenty decisions were studied, rather than the anticipated fifteen.

However, given the time constraints, the cut off point for data collection was set at the Ukrainian parliamentary elections on March 18th, 1994. Commentators differed in their assessment of the significance of these elections. It was felt that they might end in turmoil and lead to civil war, perpetuate the fragmentation of Parliament or have little impact. Whatever the outcome, it was assumed that the context would switch once again either positively or negatively.

This cut-off point was determined in response to one of the negative consequences of the contextual changes. As highlighted in chapter three, negative changes in the context prompted increased consideration by firms of the possibility of withdrawal from Ukraine. As a result, the research instrument was amended to incorporate two additional questions covering criteria for exit. Moreover, the contextual differences necessitated care in ensuring the comparability of earlier and later data. An additional phase of data collection was carried out in March 1994, in which all respondents were interviewed. However, this placed limitations upon the number of additional cases, which could be added to the study.

An additional challenge for this study was that of isolating the explanatory variables, which are firm and strategy-dependent, from those which are country and environment-specific. This bias is limited, as far as possible, by use of a case study methodology which analyses investment decisions in their context, rather than in isolation. However, it is difficult to determine the extent to which data were biased throughout the study by knowledge of the worsening conditions in Ukraine.

Furthermore, the predominantly negative mood in the latter part of data collection resulted in an increasing reluctance of firms to talk about their strategy in Ukraine. Respondents were reluctant to give bad news. Moreover, in some cases the Head Office was involved in decisions of withdrawal. Some respondents were no longer authorised to participate in the study. This placed greater emphasis on secondary data, giving an "official line," which might introduce an element of bias.

9.1.2 Use of Key Informants

Given the size of the firms studied, the investment decision in Ukraine was not always viewed as being very significant. In order to ensure the objectivity and validity of the data collected, multiple sources of evidence were used. However, it was often found that there was only one expatriate representative of the firm in Ukraine. Moreover, only one key person might have been involved in the decision to enter Ukraine. Thus, there is a heavy reliance upon data gathered from key informants. However, respondents were interviewed in both the Ukrainian subsidiary and western end of the entry decision in eight cases. Supplementary data from sources internal and external to the firm were used to verify data.

9.1.3 Historical Bias

As with many decision-making studies, there were problems, at times, in identifying the respondents who were involved in the decision-making process. Fortunately respondent firms had entered Ukraine since liberalisation in all but one case. Therefore, memories of the process are reasonably fresh. However, there are some cases where the original decision to enter did not involve any of the people currently working for the firm. In such cases, information may have been distorted in transferral. Also, the information which is now communicated may be biased by subsequent positive or negative outcomes.

9.2 Future Research Directions

In the course of this study, a number of areas arose, which could not be researched within the constraints of a PhD thesis. However, these may merit attention in subsequent research:

1. Further longitudinal study will allow for the continued study of the impact of environmental changes upon investment decisions.

2. Both small, entrepreneurial firms and multinational corporations were operating in Ukraine at the time of data collection. The focus of this study was upon large, multinational corporations. However, the study could be broadened to encompass a greater variation in size and degree of internationalisation of firms.

3. The extent to which data are context-specific could be explored by studying the investments of the same firms in other Eastern European markets, in which the transition process has moved forwards further. This would show the extent of the bias in data gathered in Ukraine, which results from the downturn in market attractiveness.

4. The findings of this study could be generalised by means of a further quantitative phase of research. Explanatory variables for the decision to enter Ukraine and the level of commitment chosen are postulated in the conclusion to Chapter six. Data collection in Ukraine allowed the identification of a database of multinational firms operating in Ukraine. Use of a questionnaire covering these variables would allow statistical validation of the conclusions of this study.

5. An additional area, which might merit further attention is that identified by Johanson and Mattsson (1988). They raise the question of how firms build positions in global networks. Further exploration of the relationships between

multinational corporations and their customers, or with external funding bodies, may provide valuable insights into this question.

7. Additionally, the growing body of literature, which explores marketisation in Eastern Europe might be enhanced by further analysis of the nature of exchange in Ukraine. This would involve further study of the Ukrainian firms.

Codicil

Since completion of the data collection for this thesis, the market environment in Ukraine has continued to be equally turbulent. In March 1994, the outlook for Ukraine appeared bleak:

> "Four seemingly intractable problems held it in thrall: failure to implement economic reform; a widening political divide between the nationalist west and the pro-Russian east of the country; secessionism in Crimea; and the rusting stockpile of nuclear weapons" (Economist, November 19th, 1994).

The outcome of the March 1994 elections brought no immediate changes. However, the election, in June 1994 of Leonid Kuchma as the Ukrainian President may have brought the long awaited impetus needed for successful transition. November 1994 saw the liberalisation of prices. In January 1995, the mass privatisation of medium and large-scale enterprises in Ukraine began (Financial Times, January 28th/29th 1995). The negative slide has seemingly been arrested. The Economist (November 19th, 1994) concludes:

> "Doubts remain on all fronts. But, for the first time, all four problems seem to stand a chance of being resolved."

The Ukrainian context has taken a positive swing. Consequently, the investment activity of the multinational corporations studied has altered once more. Neither of the firms contemplating withdrawal at the end of the study did so. Furthermore, firm D1 in the chemical industry has entered a joint venture agreement in the market. The two remaining Big Six accounting firms have entered the market and a new tier of multinational firms are prospecting Ukraine.

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17-Mar-95 **Positive and Negative Press Coverage of Ukraine**

Economist	Positive				Negative			
	Invest/ment	Prospect/ive	Opportunity	Total Pos	Threat	Risk	Crisis	tot neg
Mar 94			2	2	3		1	4
Feb 94		1		1		1	2	3
Jan 94	1			1	3	2	1	6
Dec 93		3	3	6	4	1	1	6
Nov 93	3			3	2	1	2	5
Oct 93		1		1	3	1	1	5
Sep 93		2	1	3	1	3	3	7
Aug 93			1	1	2	1		3
Jul 93	1	1	2	4	4	1		5
Jun 93	1			1	3	2	3	8
May 93		1	1	2		2	1	3
Apr 93	1	1		2	3	2		5
Mar 93				0	2	1		3
Feb 93	2		1	3	1	1		2
Jan 93	2	1		3	2	2	1	5
Dec 92	4	1	1	6	5	1	2	8
Nov 92	2	1		3	3		2	5
Oct 92	1			1				0
Sep 92				0	2	1	1	4
Aug 92	1			1				0
Jul 92	2	2	1	5	1	1		2
Jun 92	1		1	2	1			1
May 92	1	1	1	3	3	1		4
Apr 92	1			1	1		1	2
Mar 92	1	1		2				0
Feb 92	4			4	3		1	4
Jan 92	2			2	2	1	3	6
Dec 91	3	3	1	7	2	2	1	5
Nov 91	1			1			1	1
Oct 91	1			1	1	1		2
Sep 91	1	2	1	4	1			1
Aug 91	5	2	4	11	4	4	2	10
Jul 91	1	2	1	4		2	1	3
Jun 91				0			1	1
May 91				0				0
Apr 91	1			1			2	2
Mar 91		1		1	2	1		3
Feb 91				0				0

Wall Street Journal	Positive				Negative			
	Invest/ment	Prospect/ive	Opportunity	Total Pos	Threat	Risk	Crisis	Total Neg
Mar 94	5	2	2	9	9	1	5	15
Feb 94	1		1	2	4	2	1	7
Jan 94	10	5	3	18	12	5	4	21
Dec 93	10	2	1	13	4	5	4	13
Nov 93	6		1	7	3	1	3	7
Oct 93	5			5	1		1	2
Sep 93	2	1	1	4	2	1	6	9
Aug 93	2		4	6	8	5	1	14
Jul 93	2		2	4	3	1	2	6
Jun 93	7	2	1	10	1	4		5
May 93	2		2	4	3	2	1	6
Apr 93	5	2		7	1	3	1	5
Mar 93	5	2	1	8	6	2	4	12
Feb 93	12	2	2	16	2	3	3	8
Jan 93	8	2	1	11	3	1	1	5
Dec 92	4	3	1	8	4	3		7
Nov 92	10	2	2	14	2	1	3	6
Oct 92	8	4	2	14	3	4	1	8
Sep 92	2	1	2	5		2	2	4
Aug 92	3		1	4	2	1		3
Jul 92	7			7	1	4		5
Jun 92	4	1	1	6	4	2	3	9
May 92	9	2	2	13	3	3	1	7
Apr 92	3	4	2	9	4	3	7	14
Mar 92	9	5	4	18	4	4	2	10
Feb 92	7	2	3	12	2	1		3
Jan 92	7	4	4	15	4	4	2	10
Dec 91	11	11	6	28	8	11	14	33
Nov 91	6	3	3	12	2	4	4	10
Oct 91	4	3	2	9	3	2	6	11
Sep 91	4	4	2	10	4	6	2	12
Aug 91	6	6	11	23	6	10	11	27
Jul 91	2		2	4		2	2	4
Jun 91	2	1	1	4	1		1	2
May 91		1		1	1	1	2	4
Apr 91	1	1	1	3	1			1
Mar 91	2	2	1	5	2		3	5

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	Positive							
	Invest/ment	Prospect/ive	Opportunity		Threat	Risk	Crisis	
Mar 94	12	5	3	20	6	5	10	21
Feb 94	4	4		8	4	1	4	9
Jan 94	8	4	5	17	7	5	6	18
Dec 93	3	3	1	7	9	4	6	19
Nov 93	7	3		10	7	2	4	13
Oct 93	10	2	7	19	3	4	6	13
Sep 93	10	1	4	15		2	4	6
Aug 93	3	2	1	6	3		5	8
Jul 93	2	1	1	4	4		5	9
Jun 93	5	1	2	8	5	4	7	16
May 93	6	3	4	13	1	2	4	7
Apr 93	2	2		4	2	1		3
Mar 93	10			10	1	2	7	10
Feb 93	10		1	11	5		4	9
Jan 93	12	3	1	16	5	2	6	13
Dec 92	6	3	1	10	2	1	3	6
Nov 92	5	1	2	8	1	1	7	9
Oct 92	9	2	3	14	3		3	6
Sep 92	10	1		11	2	2	2	6
Aug 92	4			4			1	1
Jul 92	10	2	1	13	5		2	7
Jun 92	6	2	4	12	2		2	4
May 92	9	2	4	15	2	2	3	7
Apr 92	2	2		4	3	1	3	7
Mar 92	12	4	2	18	3	1	6	10
Feb 92	6	7	3	16	5	1	5	11
Jan 92	9	2	5	16	13	6	4	23
Dec 91	9	8	1	18	8	6	13	27
Nov 91	2	4	2	8	4	1	3	8
Oct 91	7	2	1	10	7	4	9	20
Sep 91	10	5	5	20	7	2	8	17
Aug 91	4	4	6	14	8	7	17	32
Jul 91	5	2	3	10	3		8	11
Jun 91	4	2		6	1	1	5	7
May 91	1		1	2	1	1	3	5
Apr 91	1	1	1	3		1	2	3
Mar 91	3		3	6	1		5	6
Feb 91	2	1		3		1	1	2
Jan 91		1	1	2	5		3	8
	240	92	79	411	148	73	196	417

Total	Positive				Negative			
	Invest/ment	Prospect/ive	Opportunity	Tot. Pos	Threat	Risk	Crisis	Tot Neg.
Mar 94	17	7	7	31	18	6	16	40
Feb 94	5	5	1	11	8	4	7	19
Jan 94	19	9	8	36	22	12	11	45
Dec 93	13	8	5	26	17	10	11	38
Nov 93	16	3	1	20	12	4	9	25
Oct 93	15	3	7	25	7	5	8	20
Sep 93	12	4	6	22	3	6	13	22
Aug 93	5	2	6	13	13	6	6	25
Jul 93	5	2	5	12	11	2	7	20
Jun 93	13	3	3	19	9	10	10	29
May 93	8	4	7	19	4	6	6	16
Apr 93	8	5	0	13	6	6	1	13
Mar 93	15	2	1	18	9	5	11	25
Feb 93	24	2	4	30	8	4	7	19
Jan 93	22	6	2	30	10	5	8	23
Dec 92	14	7	3	24	11	5	5	21
Nov 92	17	4	4	25	6	2	12	20
Oct 92	18	6	5	29	6	4	4	14
Sep 92	12	2	2	16	4	5	5	14
Aug 92	8	0	1	9	2	1	1	4
Jul 92	19	4	2	25	7	5	2	14
Jun 92	11	3	6	20	7	2	5	14
May 92	19	5	7	31	8	6	4	18
Apr 92	6	6	2	14	8	4	11	23
Mar 92	22	10	6	38	7	5	8	20
Feb 92	17	9	6	32	10	2	6	18
Jan 92	18	6	9	33	19	11	9	39
Dec 91	23	22	8	53	18	19	28	65
Nov 91	9	7	5	21	6	5	8	19
Oct 91	12	5	3	20	11	7	15	33
Sep 91	15	11	8	34	12	8	10	30
Aug 91	15	12	21	48	18	21	30	69
Jul 91	8	4	6	18	3	4	11	18
Jun 91	6	3	1	10	2	1	7	10
May 91	1	1	1	3	2	2	5	9
Apr 91	3	2	2	7	1	1	4	6
Mar 91	5	3	4	12	5	1	8	14
Feb 91	2	2	1	5	1	2	3	6
Jan 91	0	3	1	4	9	3	11	23
	477	202	177	856	340	217	343	900

Appendix 2 Sample of Firm Demographic Details

	D2	C2	A1	A3	A4	A2	E2	B1	B2	D3	D1	A5	A6	C1	E1	Total
a) Total Sales $ millions	23353	27026	4975	4948	3603	5406	13479	1581	6127	57725	102697			3400	2624	21193
b) Total Employees	123600	94000	17000	59797	12630	20000	118529	22190	17700	111900	133000	1300	100	13400	24258	57319
Degree of internationalisation																
a) Sales ex home country %	71	45	70	50	67	58	44	74	53	65	49			75		60
b) No. countries with investments	16	47	121	67	110	111	14	17	31	17	119	25	7	47	39	61